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U.S. TRADE PERFORMANCE
MID-YEAR 1984
AND OUTLOOK

Prepared by:
Office of Trade and Investment Analysis
International Trade Administration
U.S. Department of Commerce

Project: DTR-27-84

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U.S. DEPARTMENT OF COMMERCE
International Trade Administration

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EXECUTIVE SUMMARY

The Trade Balance

- The U.S. merchandise trade deficit in the first half of 1984 was double the deficit in the first half of 1983, $59.8 billion versus $27.3 billion. The 1984 first half deficit was at an annual rate of $119.5 billion, compared to $69.4 billion for all of 1983.

- The deficit increase was caused by rapid growth in imports--up 31 percent compared to the first half of 1983--while exports grew by only 8.1 percent. Much of the import growth was in the first quarter of 1984.

- Most of the deficit increase in 1984 can be attributed to manufactures trade. Our manufactures deficit increased by $27.1 billion--from $11.6 billion to $38.7 billion.

- Large first half 1984 increases in imports of manufactures occurred across the board--in capital goods, industrial supplies, automotive products and consumer goods.

- In 1981 and 1982 petroleum imports declined. This offset to some extent our weakening trade position elsewhere. But in 1983 oil imports again increased. This trend accelerated in 1984 with imports rising by 23 percent and accounting for 17 percent of the overall deficit increase.

- Our agricultural trade surplus, after declining in 1982 and 1983 showed a small increase in the first half of 1984. The increase, however, was far too small to significantly counter our growing manufactures deficit.

Sectoral Performance

- Product groups with the largest declines in trade balances were: petroleum and products, passenger cars, aircraft, iron and steel, apparel, consumer products, trucks and buses, and telecommunication equipment.

- Drops in both high tech and non-high tech products caused the decline in our manufactures balance.

- The high tech trade balance fell from $11.5 billion in 1983 to only $3.7 billion in 1984. The cause was import growth of more than 50 percent matched against export growth of only 4.7 percent. The largest import increases were in telecommunications equipment and electronic components, $4.5 billion (55 percent), and ADP equipment and parts, $2.2 billion (77 percent).

- Imports of non-high tech goods grew more slowly than high tech imports but growth was substantial (37 percent). In dollar terms, however, non-high tech accounted for 70 percent of the increase in manufactures goods imports. The largest increases were: passenger cars ($3.7 billion), iron and steel ($2.3 billion), and apparel ($1.97 billion).

- In the non-manufactures area agriculture showed a small increase in its trade surplus, mainly as a result of high prices for farm products. Coal exports picked up from the first half of 1983 but are still well below levels in earlier years.

Regional Aspects

- On a regional basis our trade balance deteriorated with all our major trading partners and regions. The largest decline was with Japan. But the rapid decline from surplus to a substantial deficit with the European Community was most striking. Our deficit with Japan continues to rank first, but our deficit with four East Asian NICs (South Korea, Hong Kong, Taiwan and Singapore) now ranks second, ahead of Canada.

- The most dramatic shift was in our trade balance with the EC. After years of surpluses, our trade with the EC is now in deficit. A $1.3 billion rise in auto imports from the EC and a $770 million increase in imports of petroleum products were the major factors in our declining position.

- Our deficit with Japan increased as a result of a 41 percent increase in imports. Consumer electronics increased the most, followed by autos. High tech goods, which were about 35 percent of total U.S. imports from Japan, accounted for 45 percent of the import increase.

Causes of the Deficit

- Principal causes of the deficit clearly are the strong dollar and rapid domestic economic growth coupled with weak growth overseas. The dollar is now 34 percent above its level in 1980 (14 country average); since second quarter 1983 it has gone up 5 percent. The effects of this continuing appreciation are still being felt.

- U.S. economic growth continues to far outstrip that of our major trading partners. The GNP of the major EC countries increased only 2.4 percent in the first quarter and for the year we expect growth of only 2.5 percent. By contrast the U.S. economy grew 10.1 percent at an annual rate in the first quarter and 7.5 percent in the second.

- Based on simulations using an econometric model, it appears that the major portion of our trade deficit growth stems from the high dollar rather than from the faster U.S. growth. This is reflected in the rapid growth in import penetration.

Trade Balance Outlook

- The outlook is for a continued deterioration in our trade position. For 1984 we expect a deficit in the $130 billion range. For 1985, OTIA forecasts a deficit in the order of $170 to $175 billion. Imports are forecast to grow by 16 percent in 1985, exports by only 6.4 percent.

- A huge 1985 deficit is inescapable--already assured by events and forces that cannot be changed. For example, even if the dollar were to depreciate strongly--a precipitous fifteen percent drop as of 1 October 1984--our model predicts the 1985 deficit would remain huge, at about $145 billion, a decrease of only about $25 billion in the projected 1985 deficit.

BOP/International Investment Position Effects

- The burgeoning merchandise trade deficits are overwhelming our traditional surpluses in the service accounts, creating huge current account deficits--$42 billion in 1983, increasing to an estimated $80-85 billion this year and over $100 billion in 1985.

- By definition these deficits must be financed by foreign capital. Consequently, U.S. financial liabilities to foreigners are increasing commensurately and the United States is rapidly becoming a "debtor nation". Indeed, we may have already crossed the line from a positive to a negative net international investment position and may already bae a debtor nation.

Effects on the Economy

- Imports continue to take a larger share of the domestic market. Imports as a percent of GNP increased from 7.9 percent in first half 1983 to 9.3 percent in 1984. Penetration in capital goods and consumer goods continues to grow rapidly. U.S. imports of capital goods now represent around 22 percent of domestic purchases compared to 11 percent in 1978.

- In terms of aggregate employment, effects of the large deficit are hard to quantify. In some industries, such as apparel and steel, employment displacement is taking place. But for the economy as a whole it is unlikely that economic growth could be much more rapid and employment growth faster without overheating.

- The effects of huge trade deficits will become more noticeable as the domestic economy slows down. While the economy grows rapidly, imports can be more readily absorbed. In fact, because of rapid domestic growth, imports act as a relief valve, defusing inflationary pressures.

PREFACE

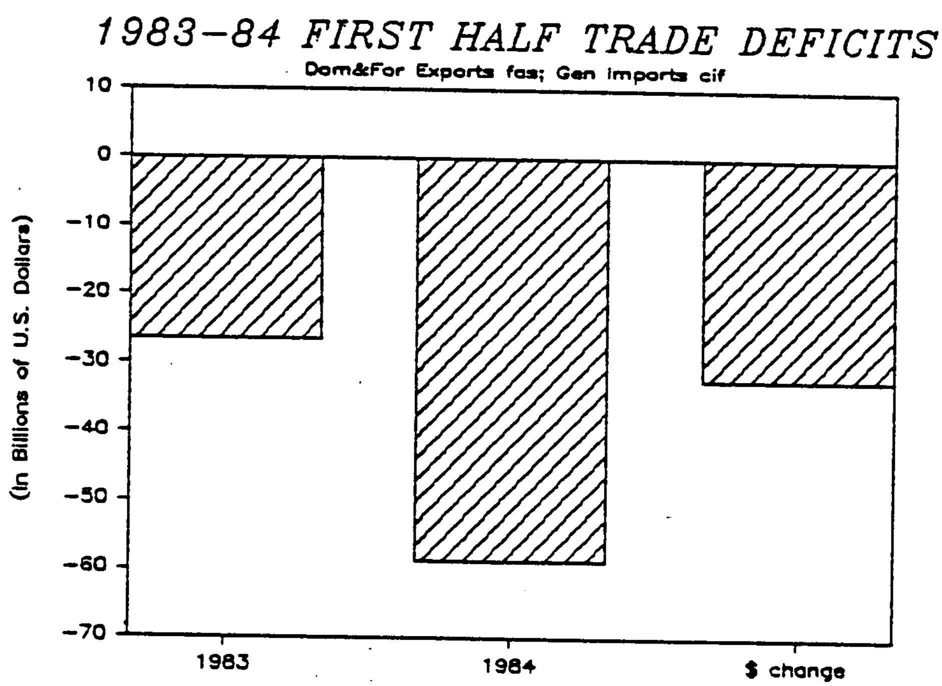
This mid-year report is part of an on-going analysis that will culminate in a full year report to be released early in 1985. The report focuses on U.S. merchandise trade developments in the first half of 1984 compared with the first half of 1983, and places these changes against the background of the broader pre- and post recession trends.

This mid-year report is not intended to be comprehensive but to serve as an update of the recently published annual report "U.S. Trade Performance in 1983 and Outlook". The report was prepared for internal use and should not be disseminated outside the department without prior approval.

I. U.S. TRADE DEFICIT--OVERALL TRENDS AND BACKGROUND

In the first half of 1984 the U.S. trade deficit expanded rapidly to reach $59.8 billion, seasonally adjusted 1/, compared to $27.3 billion for the first half of 1983.2/ (Figure I.1.)

Figure I.1.

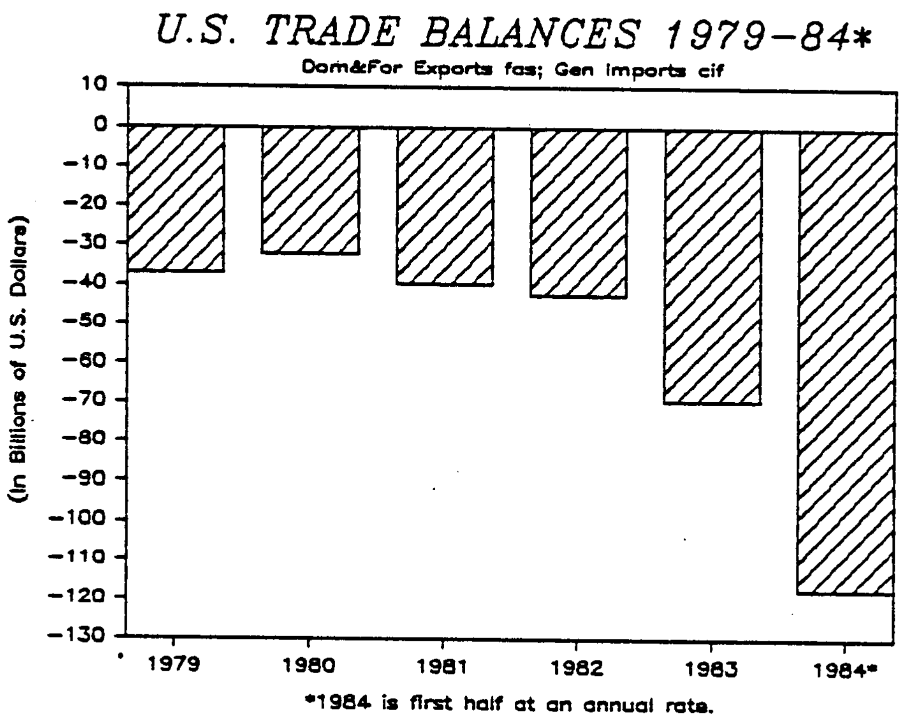


1/ Data in this report, unless otherwise specified, are not seasonally adjusted.

2/ Throughout this report, unless otherwise noted, references to 1984 growth refer to the change in first half 1984 levels compared to the first half of 1983.

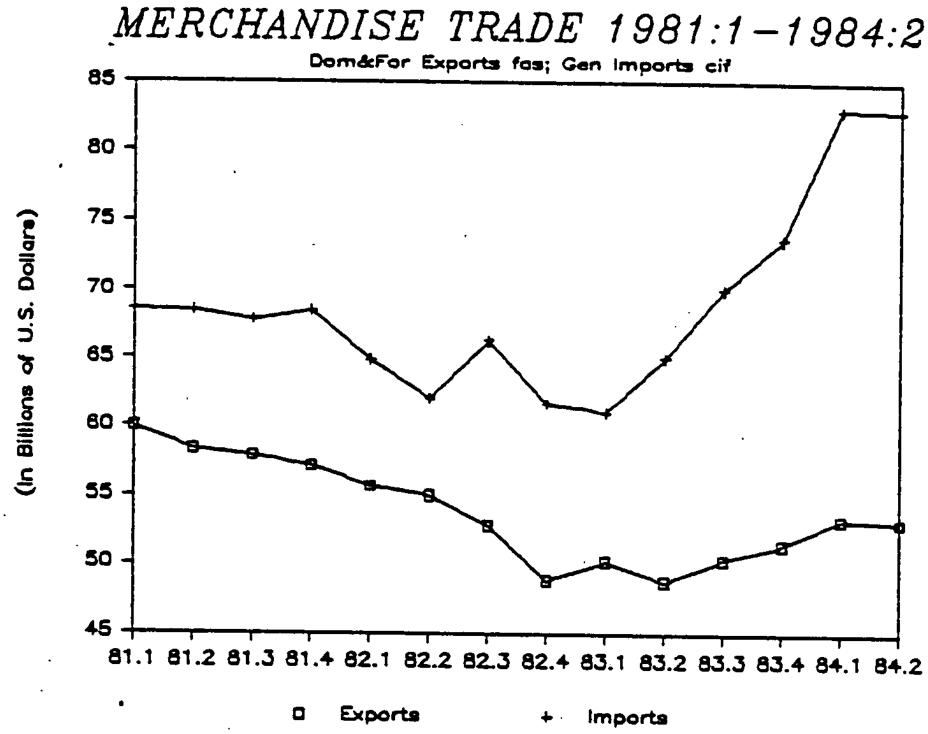
At an annual rate, seasonally adjusted, the deficit for the first half of this year was $119.5 billion compared to the 1983 full year deficit of $69.4 billion. (See Figure I.2.)

Figure I.2.



Imports in the first half of 1984 grew by more than 31 percent compared to first half 1983, while exports increased by only 8.1 percent. Most of the import growth was concentrated in the first quarter when imports increased by 12.9 percent over the fourth quarter of 1983. (See Figure I.3)

Figure I.3.

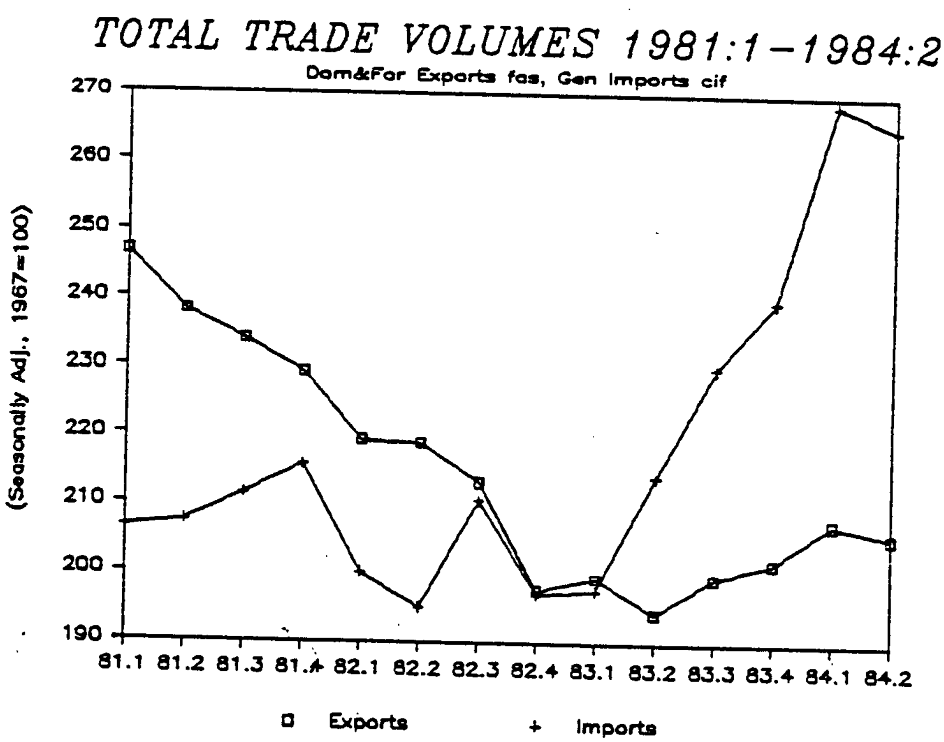


The disparity between import growth and export growth, while larger than in the recent past, is a continuation of trends in U.S. trade over the last 18 months. Both imports and exports declined during the 1981-1982 period, but beginning in 1983 imports started to grow rapidly with the strong U.S. recovery, while exports stagnated. This led to a $26.7 billion (62.5 percent) increase in the U.S. trade deficit in 1983. While exports have now begun to recover, export growth is still well below the import growth rate. Imports are now 21 percent above their pre-recession peak, while exports remain 11 percent below their pre-recession peak.

As a result of the divergence in import and export growths, the value of imports now coming into the United States is 50 percent greater than the value of exports. This magnitude of divergence cannot be quickly reversed. This means, for example, that even if exports were to grow from current levels by 10 percent a year and imports at a slower 5 percent rate, it would take more than seven years to reduce the annual deficit to $50 billion.

Import and Export price changes have been relatively small. Thus, recent trends in export and import volumes as shown in Figure I.4 are very similar to those for dollar values show in Figure I.3.

Figure I.4.



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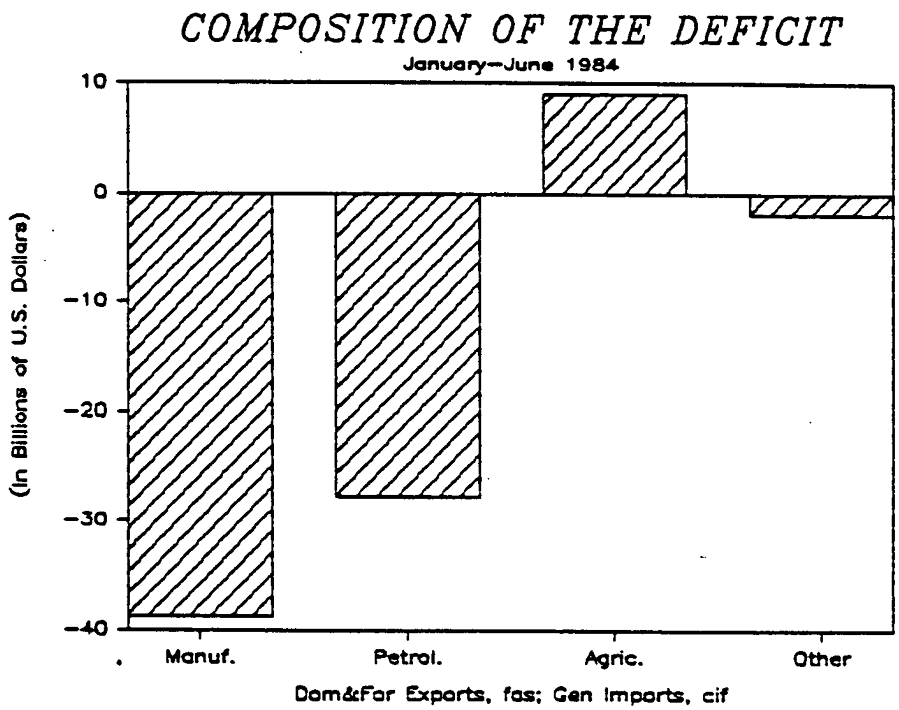
II. MAJOR COMMODITY DEVELOPMENTS

The major components of the deficit are manufactures and petroleum. (Figure II.1.)

Figure II.1.



The increase in the overall trade deficit was primarily due to growth in imports of manufactures. (See Figure II.2) Unlike the recent past, however, the increasing size of the manufactures deficit is no longer being offset by declining imports of petroleum and petroleum products. Instead, increased imports of petroleum and products were equivalent to 17 percent of the first half growth of the 1984 deficit. Table II.1. gives a breakout of the largest positive and negative changes in 1984.

Figure II.2.

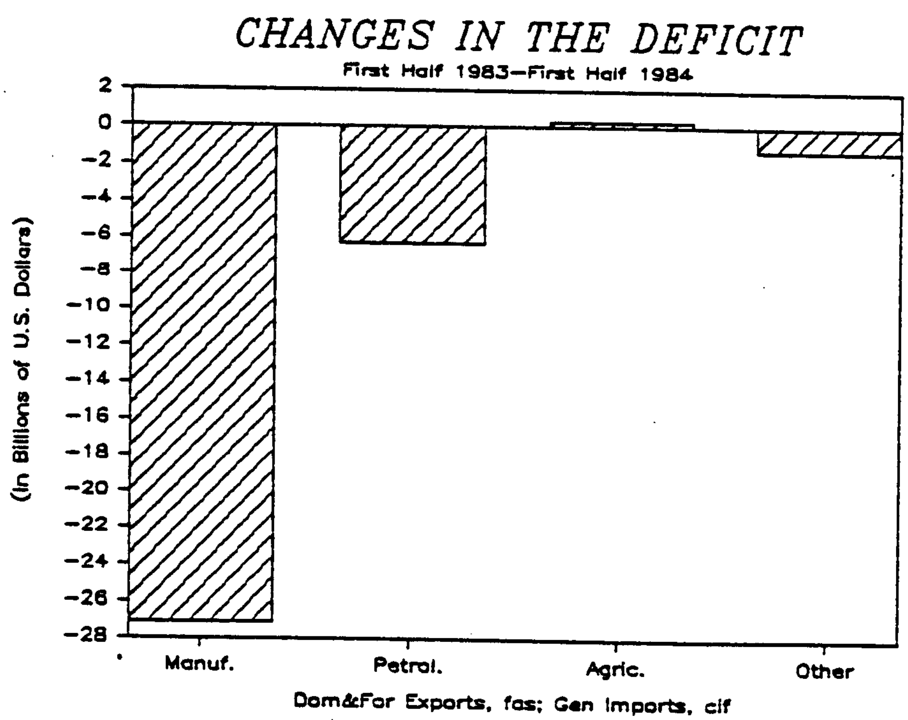


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Table II.1

PRODUCTS WITH LARGEST TRADE BALANCE CHANGES

Domestic & Foreign Exports, f.a.s.; General Imports, c.i.f.
(In Billions of U.S. Dollars)

PRODUCT	CHANGE 83/84
COAL	0.596
OILSEEDS	0.596
COTTON	0.534
CEREALS	0.330
HIDES AND SKINS	0.210
ORGANIC CHEMICALS	0.164
VEGETABLE OILS AND FATS	0.115
MISC CHEMICAL PROD	0.106
FERTILIZERS	0.100
WOOD ROUGH	0.094
AUTO PARTS	-0.359
ADP EQUIP & PARTS	-0.471
TRUCKS AND CONSTR EQUIP	-0.508
FOOTWEAR	-0.540
GOLD	-0.540
PISTON ENGINES AND PARTS	-0.588
PAPER AND PAPERBOARD	-0.661
NON-FERROUS METALS	-0.685
ELECTRONIC COMPONENTS	-0.710
YARNS AND FABRICS	-0.782
TELECOMMUNICATIONS EQUIP	-0.933
TRUCKS AND BUSES	-1.078
CONSUMER ELECTRONICS	-1.463
APPAREL	-1.968
IRON AND STEEL	-2.346
AIRCRAFT	-2.505
PASSENGER CARS	-3.195
PETROLEUM AND PRODUCTS	-5.889

Source: DOC/ITA/OTIA using official statistics of the Bureau of Census

Trade in high tech products no longer provides much offset to the U.S. deficit on other items. For the first time, shrinkage of the U.S. high tech surplus has been a major contributor to the worsening U.S. trade deficit. Indeed, if current trends continue, the U.S. could run a 1984 deficit in high tech trade.

Our surplus in agricultural products did increase a small amount in the first half of 1984, but it was not nearly enough to offset the manufacturing and petroleum declines.

TRADE IN MANUFACTURES

Manufactured goods trade accounted for nearly two-thirds of the trade deficit in the first half of 1984 and an even greater share (84 percent) of the first half 1984 growth in the deficit. The manufactured goods deficit more than tripled, from $11.6 billion in the first half of 1983 to $38.7 billion in the first half of 1984. (See Figure II.3.) If the current rate of growth continues we will have a manufactures trade deficit of $83 billion for the year compared to $38.2 billion last year. The deficit increase resulted from slow export growth coupled with rapid import growth. (Figure II.4.)

Figure II.3.

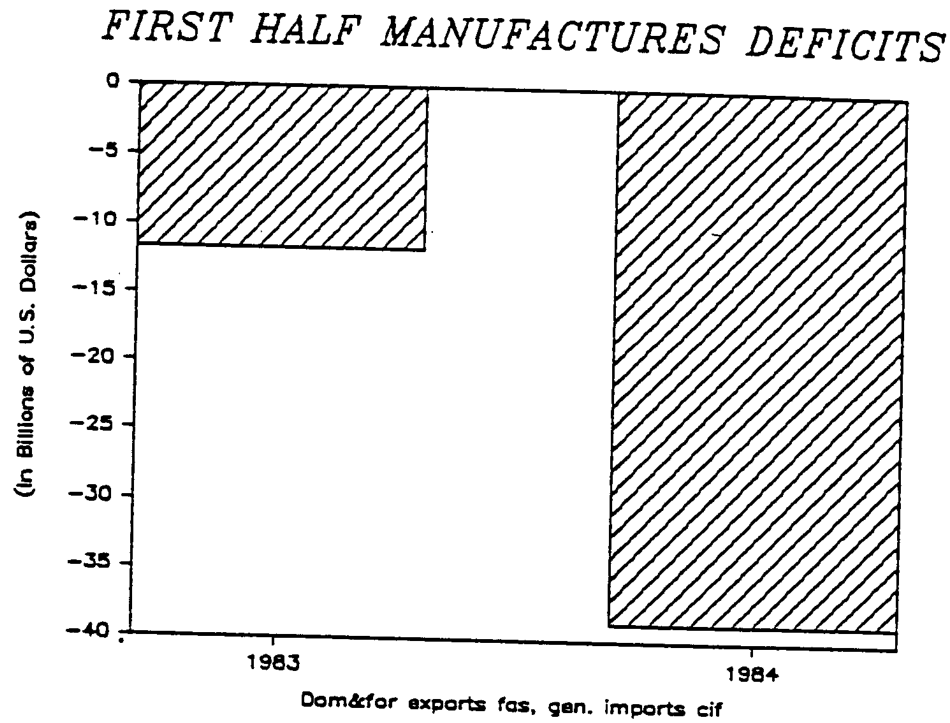
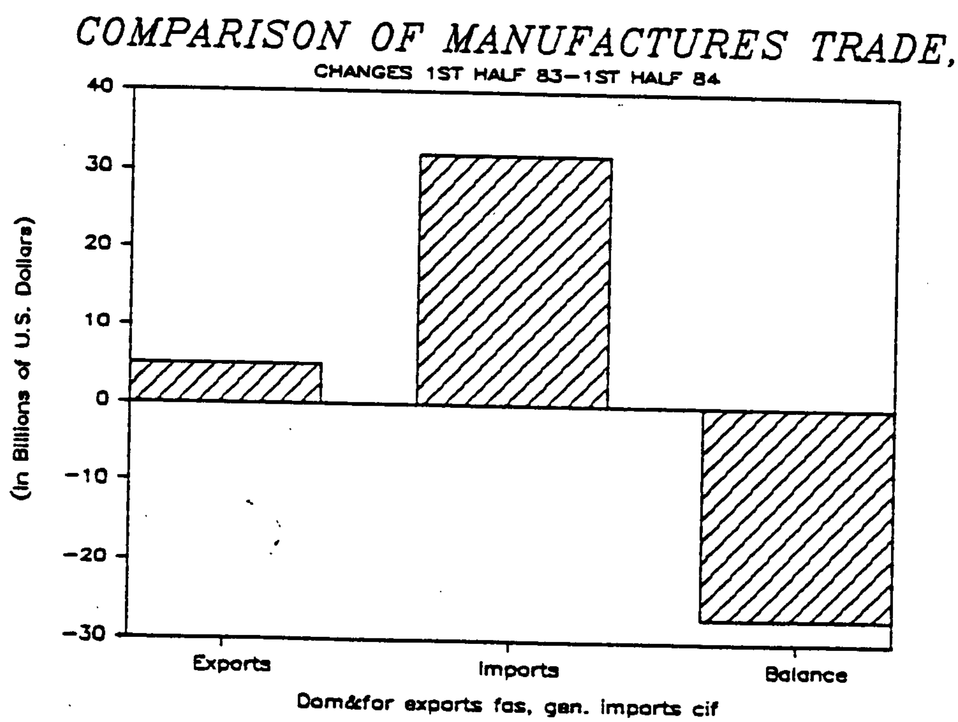


Figure II.4.



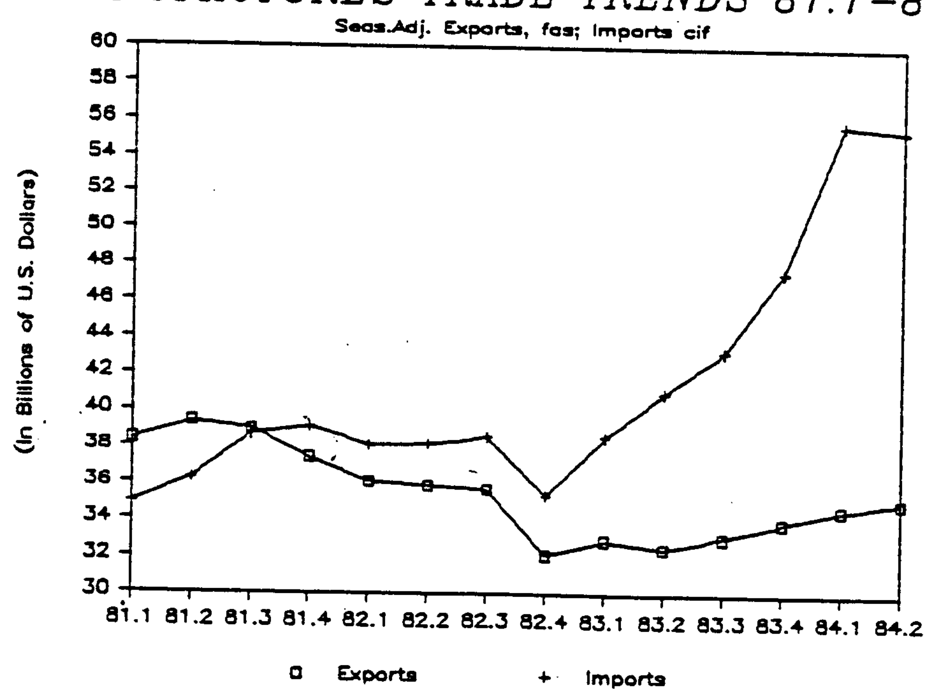
Manufactures Export Trends

In first half 1984, manufactures continued to account for two-thirds of U.S. exports. This has been the traditional share and there is no sign of any underlying downward trend. Nevertheless, manufactures exports provided only slightly less than half of the growth in total U.S. exports for first half 1984, while agricultural goods accounted for about one-fourth of the growth.

In first half 1984, exports of manufactures grew by 7.3 percent over first half 1983. This continues the upward trend in manufactures exports which began in the second half of 1983. (Figure II.5.) Manufactures exports have a long way to go, however, since second quarter 1984 manufactures exports were still 11 percent below their pre-recession peak value.

Figure II.5.

MANUFACTURES TRADE TRENDS 81:1–84:2



Indeed, on a volume basis manufactures are more than 20 percent below their previous peak in 1980. Viewed positively, however, manufactures exports are now 9 percent above their recent 1982 low.

While first half 1983 growth in manufactures exports was not rapid, Table II.2. shows that most of our leading exports did increase. Leading the list and accounting for more than 35 percent of the $5.0 billion growth in exports was a 25 percent increase in exports of automotive vehicles and parts, mostly increases to Canada under APTA (the automotive products free trade agreement).

Table II.2

EXPORTS WITH LARGEST INCREASES 83/84

Domestic & Foreign Exports, f.a.s.
(In Billions of U.S. Dollars)

PRODUCT	CHANGE
ADP EQUIP AND PARTS	1.378
MOTOR VEHICLE PARTS	1.276
ELECTRONIC COMPONENTS	0.786
ORGANIC CHEMICALS	0.640
OILSEEDS	0.574
PASSENGER CARS	0.549
COTTON	0.540
PISTON ENGINES	0.323
ELECTRICAL EQUIP	0.282
HIDES AND SKINS	0.225
ELECTRICAL MACHINERY	0.223
SPECIALIZED IND MACHINERY	0.192
TELECOMMUNICATIONS EQUIP	0.174
SYN RESINS: RUBBER & PLAS	0.146
FERTILIZERS	0.115

Source: DOC/ITA/OTIA using official statistics of the Bureau of the Census.

Even this rapid growth in motor vehicles and parts, however, is in some respects an illusion, since increases in exports of these items were more than offset by the growth in imports of the same type of products from Canada in the two-way trade under APTA.

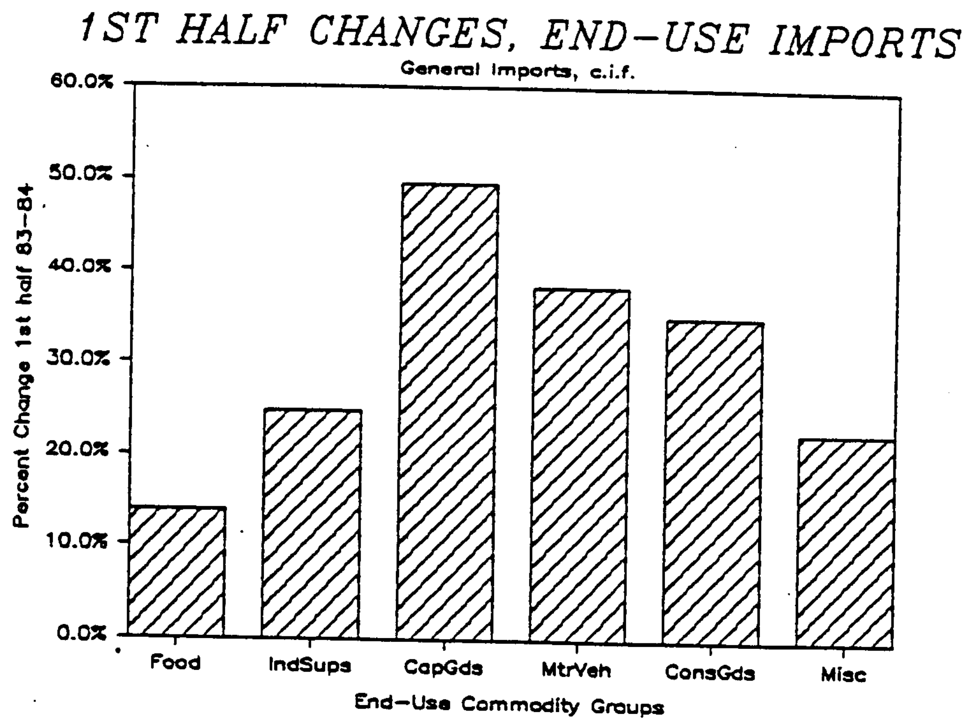
The most significant export decline was a $2.0 billion drop in aircraft, spacecraft and parts deliveries. U.S. aircraft export deliveries are scheduled to continue at this substantially lower level throughout 1984.

Manufactures Import Trends

In the first half of 1984 imports of manufactures were up 39.9 percent over the same period last year. Manufactures imports are now 57 percent above their recession low in 1982 and 42 percent above their pre-recession peak. (See Figure II.5.)

In 1984, as in 1983, imports of manufactures have risen strongly in most categories; increases have been substantial in capital goods, industrial supplies, motor vehicles and parts, and consumer goods. (Figure II.6.)

Figure II.6.



The largest import increases in individual products were in motor vehicles, and in a number of both basic and high-tech industry categories. (See Table II.3.) Almost all of the important U.S. trading partners increased their exports to the U.S.

Table II.3

IMPORTS WITH LARGEST INCREASES 83/84

General Imports, c.i.f.
(In Billions of U.S. Dollars)

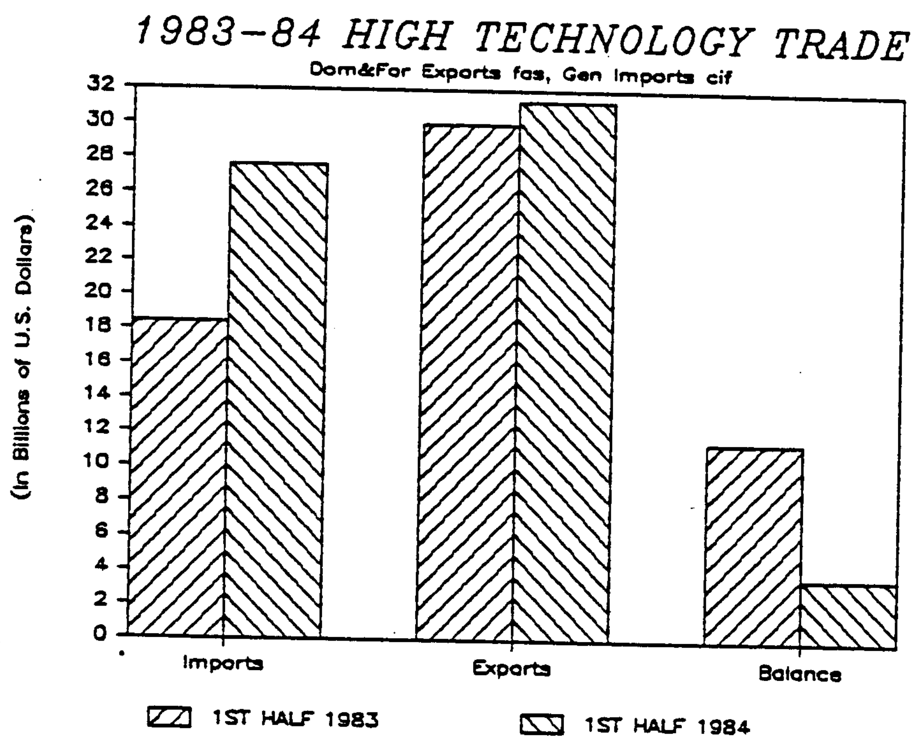
PRODUCT	CHANGE 83/84
PETROLEUM AND PRODUCTS	5.487
PASSENGER CARS	3.743
IRON AND STEEL	2.288
APPAREL	1.965
ADP EQUIP AND PARTS	1.848
MOTOR VEHICLE PARTS	1.635
CONSUMER ELECTRONICS	1.520
ELECTRONIC COMPONENTS	1.495
TRUCKS AND BUSES	1.152
TELECOMMUNICATIONS EQUIP	1.107
YARN AND FABRIC	0.776
NON-FERROUS METALS	0.735
PAPER AND PAPERBOARD	0.730
PISTON ENGINES	0.631
FOOTWEAR	0.536

Source: DOC/ITA/OTIA using official statistics of the Bureau of the Census.

High Tech Trade

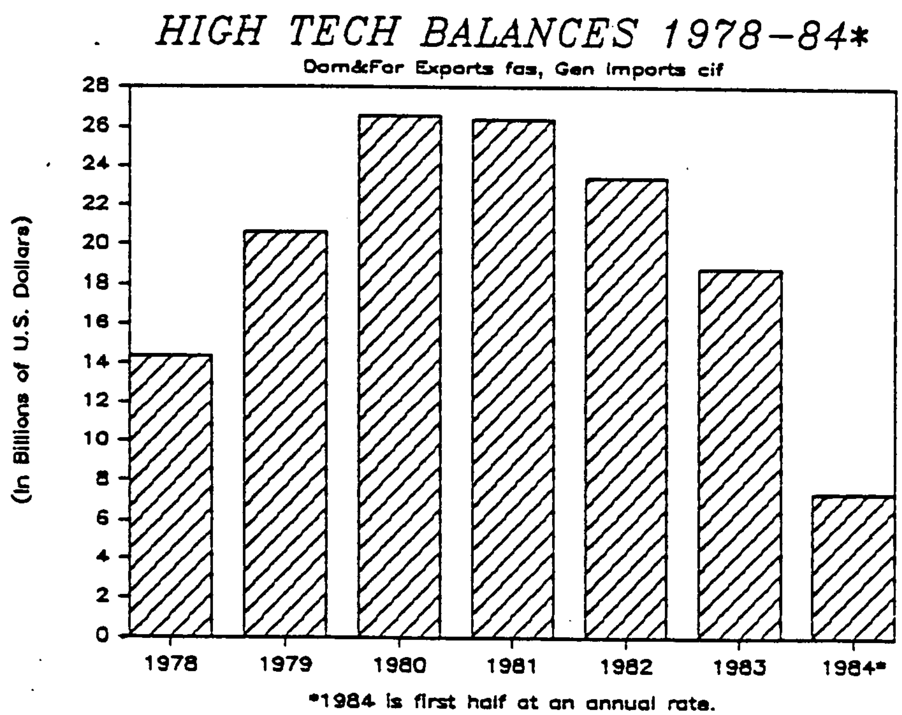
In 1984 one of the most striking developments in U.S. commodity trade was the rapid deterioration in the traditional U.S. surplus in high technology trade. Comparing the first halves of 1983 and 1984, high tech exports grew by 4.7 percent, a rise of $1.4 billion, while imports jumped by 50 percent, an increase of $9.2 billion. (Figure II.7) As a result, our surplus dropped from $11.5 billion to $3.7 billion, a 68 percent decline.

Figure II.7.



The U.S. high tech surplus began shrinking in 1981, but the pace has accelerated quickly and in the first half of 1984 our export surplus fell to less than one-fifth of its 1980 level. Figure II.8) If the current pace continues, U.S. high tech trade will be in deficit in the last half of 1984, a first. The cause of the deficit rise is rapid import growth.

Figure II.8.



The deterioration in the U.S. high tech position occurred in most product categories. The most important declines were, however, the large continued increase in the deficit in communication equipment and electronic components, and the rapidly shrinking surplus in computers and office machines and parts. Losses occurred in both consumer and producer goods in these categories.

Although the movement was more gradual, U.S. trade in industrial inorganic chemicals and in professional and scientific instruments slipped into deficits for the first time in the first half of 1984. (See Table II.4.)

Table II.4

DETAIL OF FIRST HALF BALANCES IN HIGH TECHNOLOGY TRADE

Domestic&Foreign Exports, f.a.s.; General Imports, c.i.f.
(In millions of U.S. dollars)

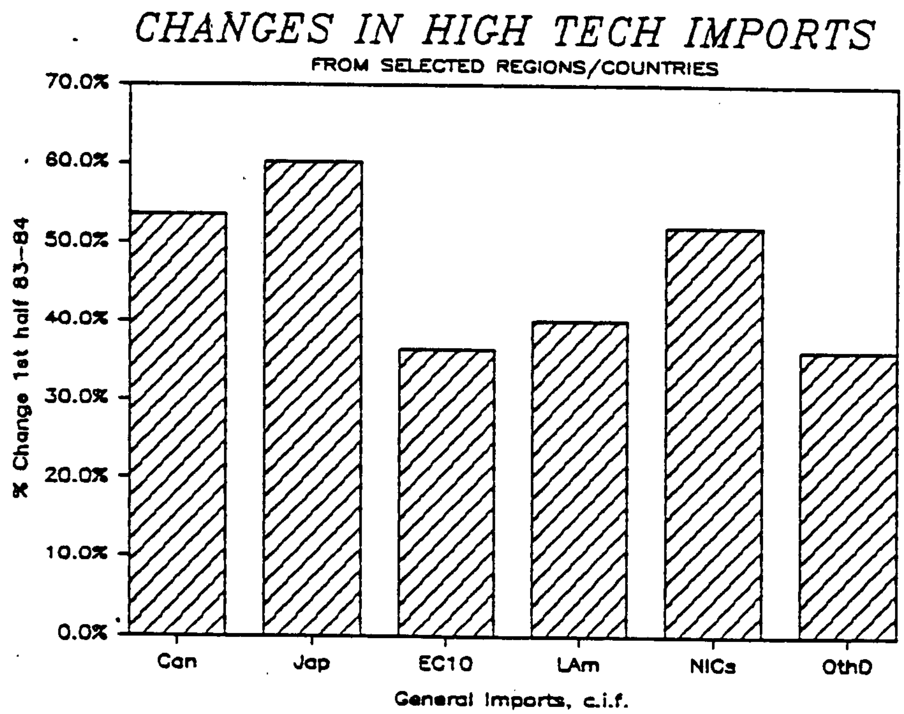
Commodity	Jan-June 1983	Jan-June 1984	$ Change 1983-84	% Change 1983-84
Guided Missles and Spacecraft------	430	472	42	9.7%
Comm Equip. and Elec Components----	-2597	-5947	-3350	-129.0%
Aircraft and Pts------------------	6920	4520	-2400	-34.7%
Office Computing and Acctg. Mach.--	2774	1938	-836	-30.2%
Ordinance and Accessories----------	340	382	43	12.5%
Drugs and Medicines----------------	632	519	-113	-17.9%
Industrial Inorganic Chemicals-----	220	-65	-285	-129.4%
Prof and Scientific Instruments----	464	-28	-492	-106.0%
Engines Turbines and Pts-----------	716	514	-201	-28.1%
Plastic mat syn resins rubber etc.-	1599	1401	-198	-12.4%
Total------------------------------	11498	3705	-7793	-67.8%

The "HIGH TECHNOLOGY" definition used here is the DOC3 definition described in the "TECHNOLOGY INTENSITY OF U.S. OUTPUT AND TRADE" by L. Davis, 5/82.

Source: DOC/ITA/OTIA using official statistics of the Bureau of the Census.

The main cause of the disappearing U.S. high tech surplus in 1984 has been the rapid growth of imports from Japan, the East Asian NICs, and to an important but lesser extent, from the rapid growth of imports from the European Community. (See Figure II.9.)

Figure II.9.



The recent growth in high tech imports has been concentrated in a few products. Nearly 50 percent of first half 1984 import growth was in communication equipment, consumer electronics and electronic components, which grew by 56 percent. Disproportionately large increases also occurred in aircraft and parts, and in office, computing and accounting machines.

Much of the increases in high tech exports also occurred in communications equipment and electronic components, which rose by 21 percent. Large increases also occurred in exports of office, computing and accounting machines (up 24 percent), but these increases were not large enough to offset import growth. As a result, our positive balance in ADP equipment and parts declined by $840 million.

Most of the import growth in communications equipment and electronic components is coming from Japan and the East Asian NICs. Latin America and the European Community account for only a small share of our total deficit in these products. There has been a similar pattern in office computing and accounting machinery import increases.

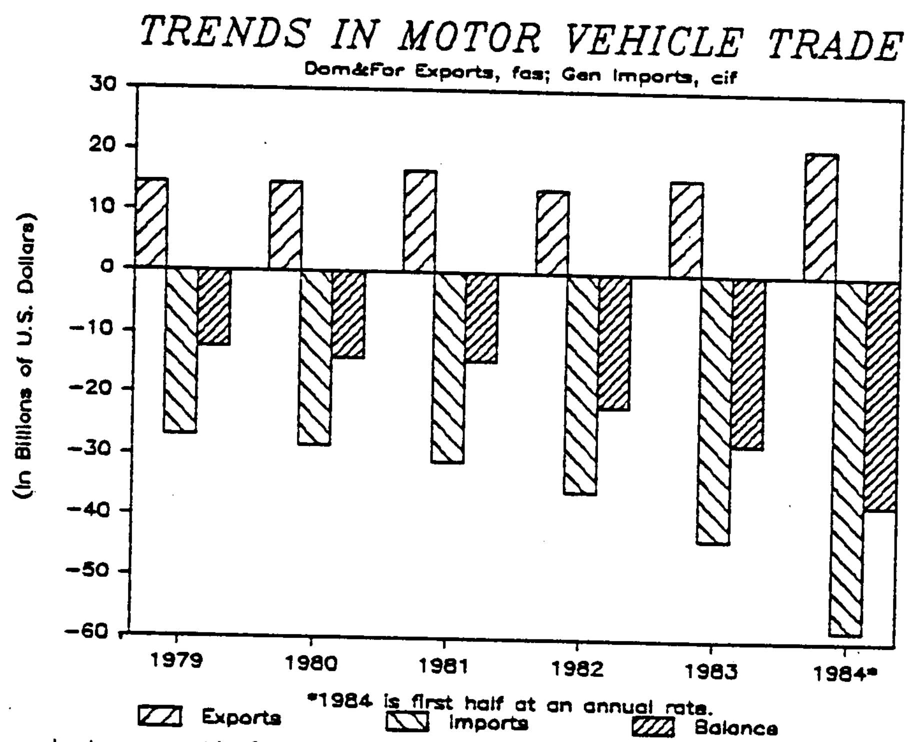
Reasons for our declining high tech surplus certainly include strong growth in domestic demand and weak growth abroad. But even high tech goods--which supposedly compete more on non-price factors than lower technology items--are being heavily affected by a dollar that has risen 34 percent since 1980.

Non-High Tech Manufactures

The U.S. trade position in virtually all non-high tech manufactures is continuing to deteriorate even more rapidly than in high tech products. These lower technology goods still account for the major share (56 percent) of U.S. manufactures exports, but the deficit in these items nearly doubled from $23 billion in first half 1983 to $42 billion for the first half 1984. This expanded deficit accounted for nearly two-thirds of the worsening in the overall U.S. trade balance.

Motor vehicles and parts was by the far the largest non-high tech manufactures contributor to deficit growth. (See Figure II.10) A large share of the motor vehicles and parts deficit increase was accounted for by increased imports from the European Community as well as from Canada and Japan. Other non-high tech products that experienced large deficit increases were apparel and steel.

Figure II.10.

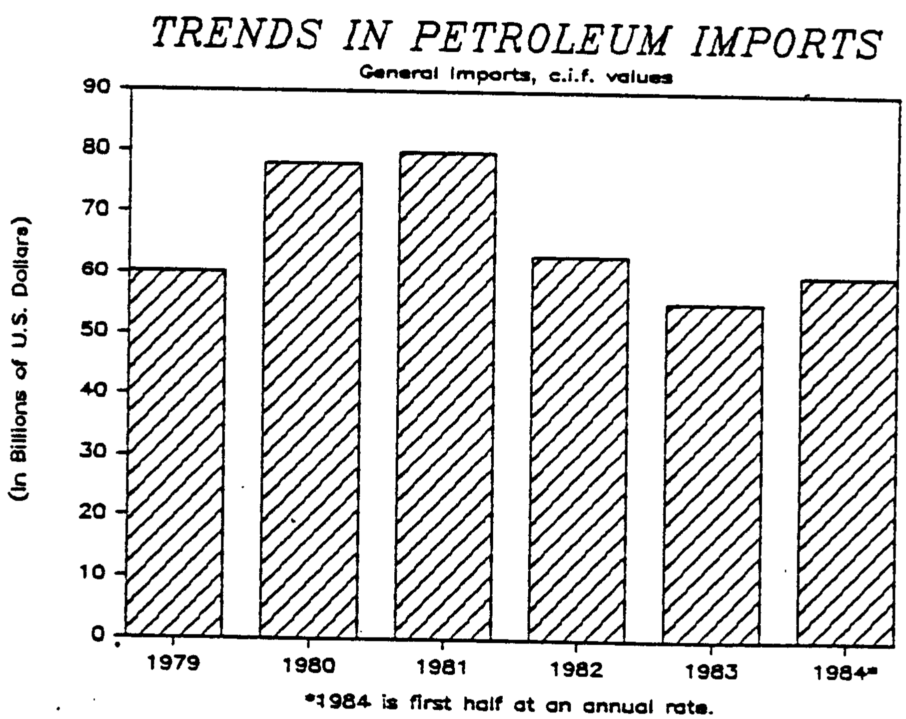


A smaller but, nonetheless, significant decline took place in our surplus in construction equipment, traditionally an important element in our trade surplus. Our 1983 surplus was $3.5 billion, down from the $5.9 billion of 1982, chiefly because of the drop in exports, especially to LDC debtor countries. But in 1984 the decline in exports continued while U.S. imports almost doubled over the first half of 1983. At an annual rate the surplus in construction equipment in the first half of 1984 was down to $2.9 billion.

PETROLEUM IMPORTS

Petroleum imports play a key role in determining the U.S. trade balance. In early 1983, the two-year decline in petroleum imports ended and growth resumed. Petroleum imports were up in value by 23 percent in first half 1984. First half 1984 petroleum imports reached an annual rate of $60.0 billion. (Figure II.11.)Volume levels are now almost equal to 1982 and, if the upward trend continues, 1984 import volumes will surpass those of 1982.

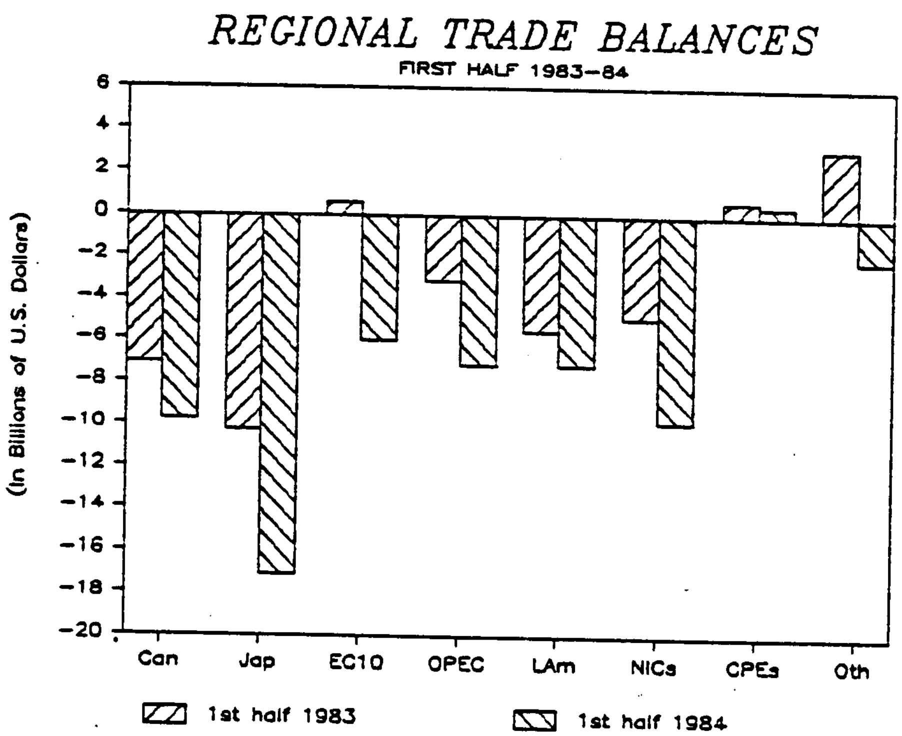
Figure II.11.



III. TRADING PARTNER DEVELOPMENTS

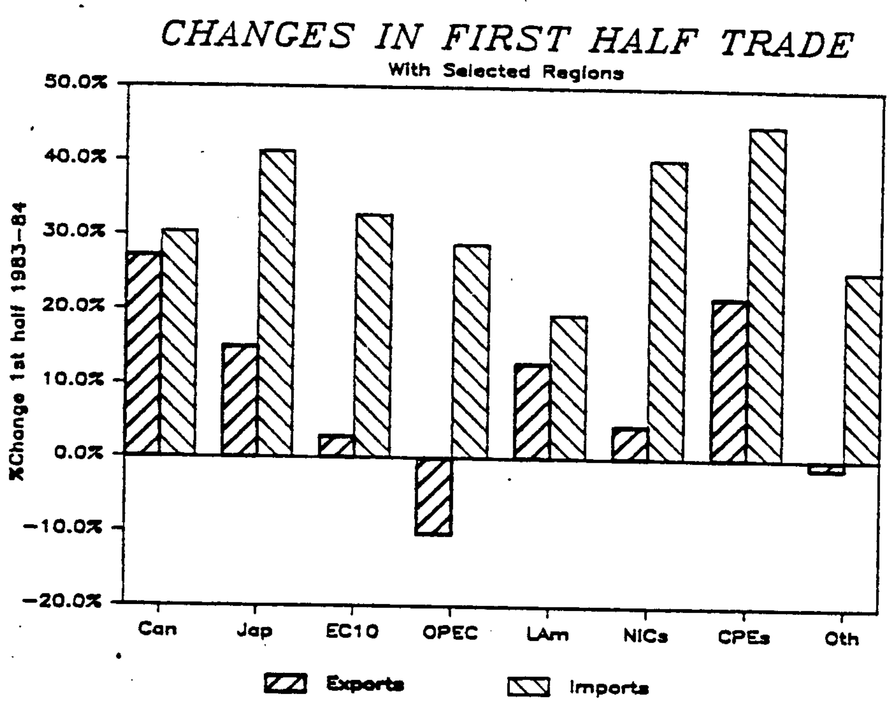
The U.S. trade position deteriorated with virtually every country and region. The largest declines were with Japan, EC, and the four newly industrializing countries of East Asia. (See Figure III.1.)

Figure III.1.



Overall, U.S. imports for first half 1984 were more than 31 percent above first half 1983, but several of our major trading partners have increased their exports to the U.S. at faster rates. Imports from Japan, Brazil, West Germany, the Netherlands, and the East Asian NICs are up by over 40 percent. (Figure III.2.)

Figure III.2.



U.S. exports overall were 8.1 percent higher in the first half of 1984, but our performance in individual key trading partner markets varied widely.

TRADE WITH THE EUROPEAN COMMUNITY

While the largest dollar increase in the deficit was with Japan, the shift in our trade balance with the EC was the most striking--from a $587* million surplus in the first half of 1983 to a $6.0 billion deficit in the

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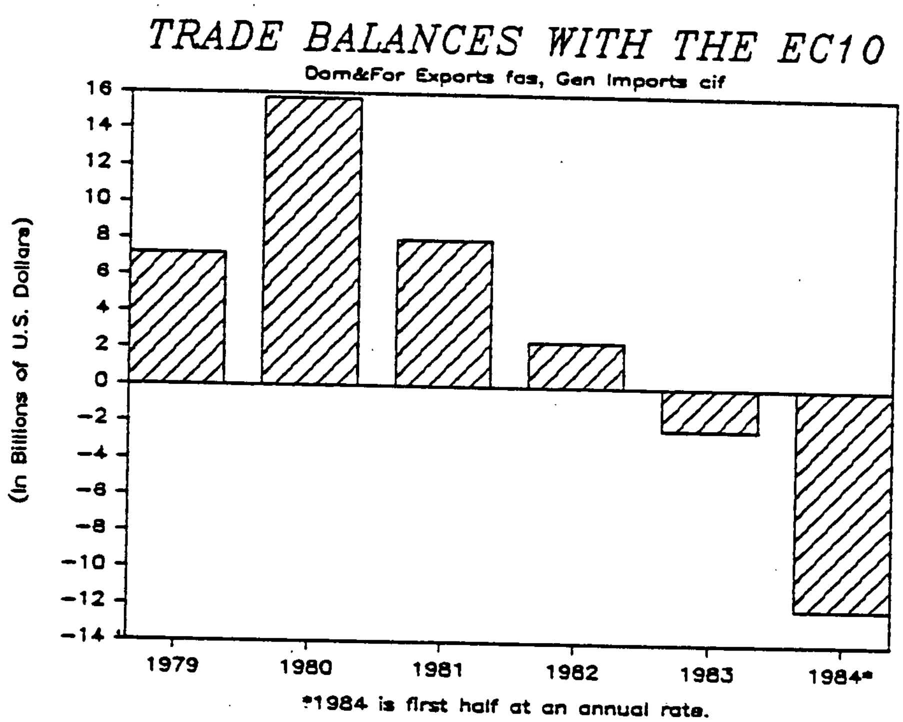
*/ Country/Region data exclude special category exports.

first half of 1984. In the second half of 1983 our trade balance with the EC had gone negative, reversing the traditional pattern of trade surpluses that we have had with the EC. This trend has accelerated in 1984. (See Figure III.3.)

Figure III.3.



Nearly three-fourths of this increase in the U.S. deficit with the EC was due to an increasing deficit in manufactures. The growth was mainly in non-high tech goods, with the high tech goods balance declining only about $500 million. In the first half of 1984 the U.S. high tech surplus with the EC-10 was $4.8 billion, but the deficit in all other goods was about $11.4 billion. Most of the 6.4 percent growth in manufactures exports to the EC-10 was high tech goods, while most of the 34.5 percent growth in manufactures imports was non-high tech goods.

In dollar terms West Germany benefited most from increased U.S. imports from the European Community. Imports from West Germany rose by $2.6 billion (41 percent) in first half 1984 over first half 1983. The only other countries from which imports grew faster than the overall 31 percent average were the Netherlands and Italy.

The largest commodity increases in imports from the EC-10 in first half 1984 were a $1.3 billion (60 percent) rise in passenger cars and a $790 million (110 percent) increase in petroleum products. On the U.S. export side most significant was a 17.6 percent drop in aircraft and parts.

The increase in U.S. imports from the European Community should be a relatively important stimulus to the EC economy in 1984, given very slow EC growth. The increase in EC sales to the United States equals about one-half percent of EC GNP and should contribute about one-fourth of the 2.4 percent growth in EC GNP growth expected in 1984.

U.S.-JAPAN TRADE

The U.S. trade deficit with Japan rose by 64 percent in the first half of 1984 compared with 1983. This continues a long downward trend. (Figure III.4.) U.S. imports were up 41 percent, while our exports rose only 15 percent. (See Figure III.5.)

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Figure III.4.

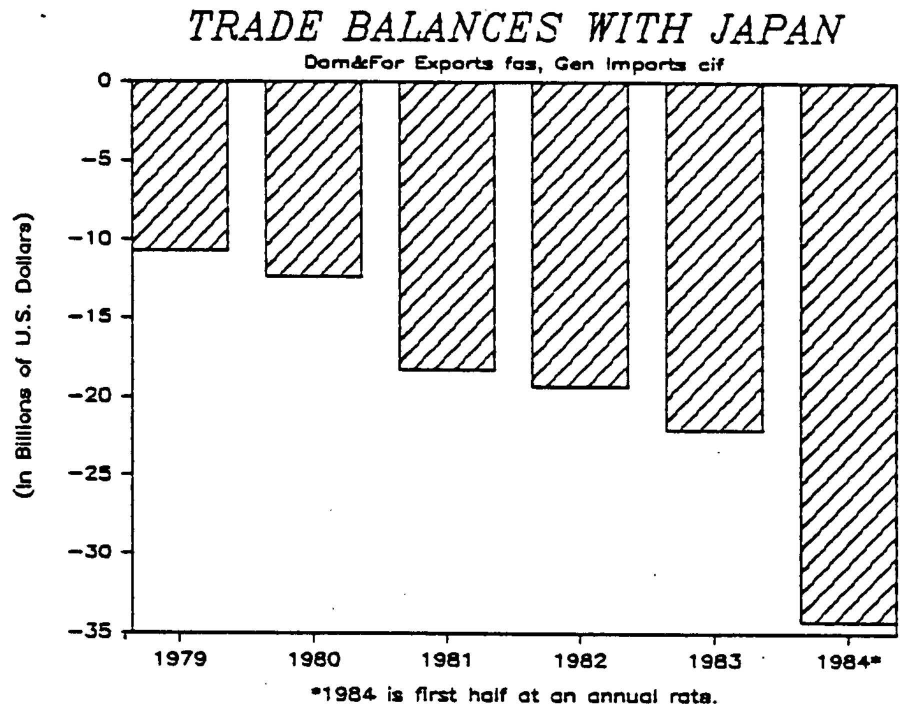
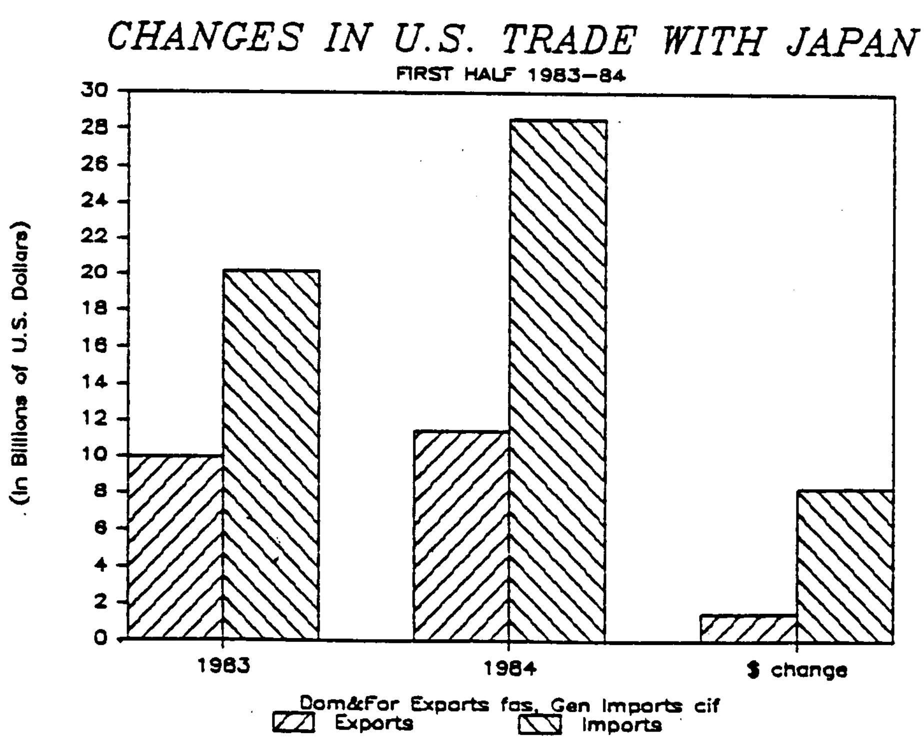
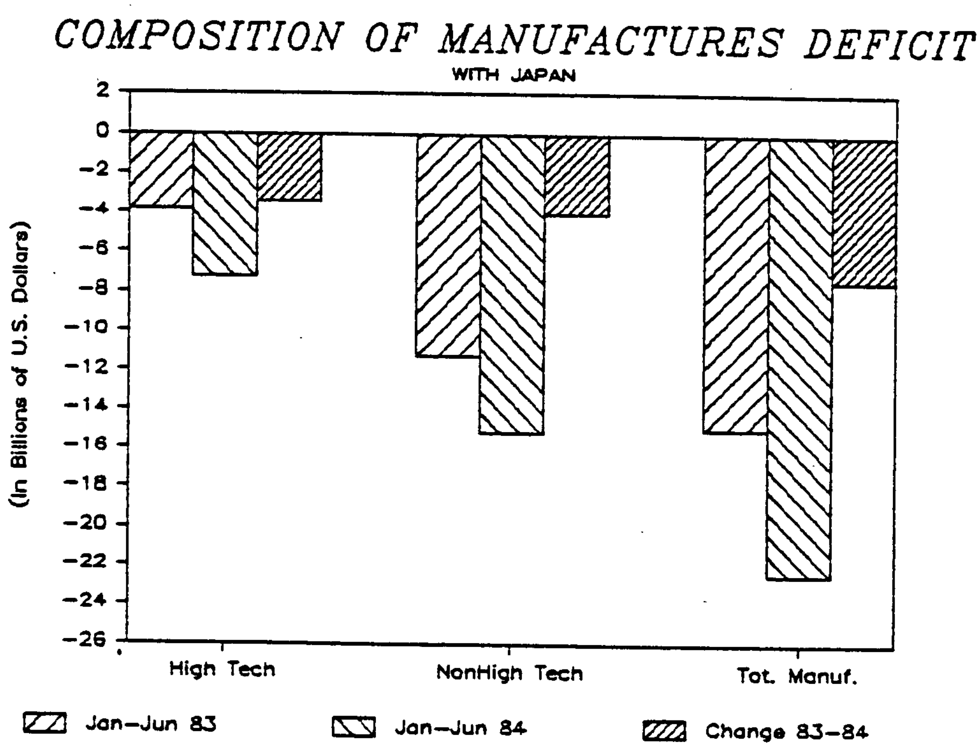


Figure III.5.



The deficit with Japan in first half 1984 reached a record $34.2 billion at an annual rate, about one-fourth of the total expected 1984 U.S. trade deficit. The composition of U.S.-Japan trade remains very unbalanced, with manufactures accounting for virtually all of the U.S. imports, but less than half of our exports. Thus, manufactures trade accounted for most of the deficit growth. (Figure III.6.)

Figure III.6.



Japan continues to be the dominant source of a number of U.S. imports. In first half 1984 Japan supplied nearly 40 percent of our passenger car imports (by value), 87 percent of phonographs and sound reproduction equipment, 54 percent of ADP machines, and 66 percent of the professional and scientific instruments.

Nearly one-fourth of U.S. imports from Japan continue to be passenger cars. In spite of Japan's voluntary quota on exports to the United

States, first half 1984 auto imports increased 15 percent in value. This reflects both the 10 percent increase in the quota and an upgrading of the models imported. Autos accounted for only 10.1 percent of the total import increase.

While only 18 percent of total U.S. imports from Japan were telecommunications equipment, consumer electronics, and electronic components, these products accounted for 26 percent of the import increase. These and other high tech products accounted for over one-third of the total imports from Japan and 45 percent of the first half 1984 increase. (Table III.1)

Table III.1

IMPORTS FROM JAPAN WITH LARGEST INCREASES 83/84

General Imports, c.i.f.
(In Millions of U.S. Dollars)

PRODUCT	$ CHANGE 83-84	% CHANGE
CONSUMER ELECTRONICS	980	65.0
ADP EQUIP AND PARTS	827	88.0
PASSENGER CARS	800	15.0
IRON AND STEEL	628	75.0
TELECOMMUNICATIONS EQUIP	590	68.0
ELECTRONIC COMPONENTS	493	100.0
AUTO PARTS	387	106.0
OFFICE EQUIP	252	50.0

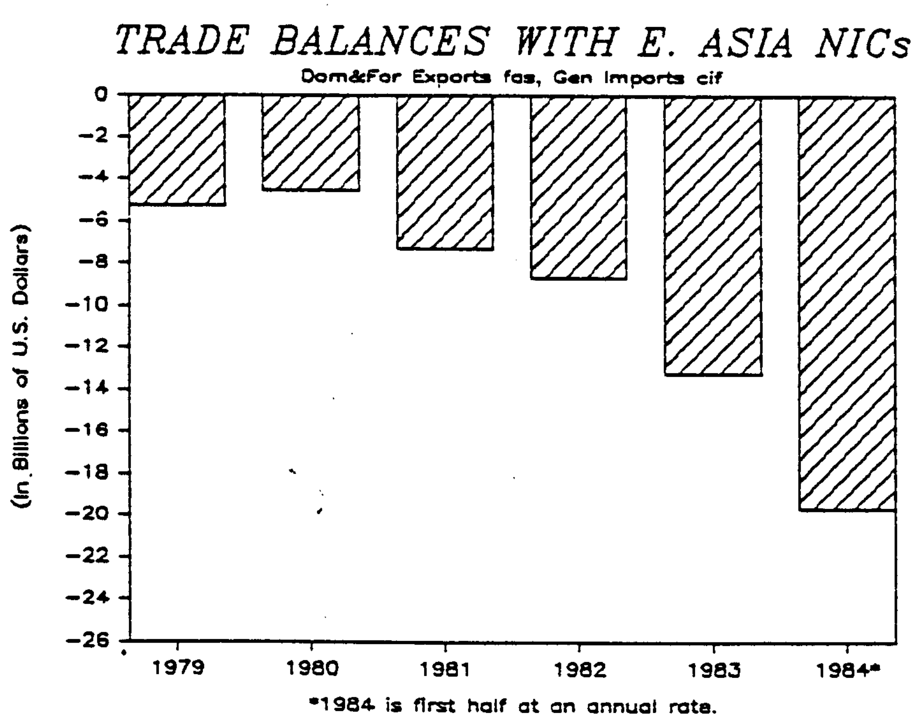
Source: DOC/ITA/OTIA using official statistics of the Bureau of the Census.

Grain, the largest U.S. export increase in our trade with Japan, was up by 43 percent, or $449 million. Exports of ADP equipment and parts increased 25 percent, by $105 million. On the downside the largest export decline was natural gas, off by $116 million. Coal exports also continued to decline from their 1982 peak.

EAST ASIAN NICs

Four East Asian newly industrializing countries, Hong Kong, South Korea, Singapore and Taiwan, were the third largest source of the first half 1984 increase in the U.S. trade deficit, surpassed only by Japan and the European Community. (Figure III.7.) These four countries have the second largest bilateral surplus with the U.S., slightly exceeding Canada.

Figure III.7.

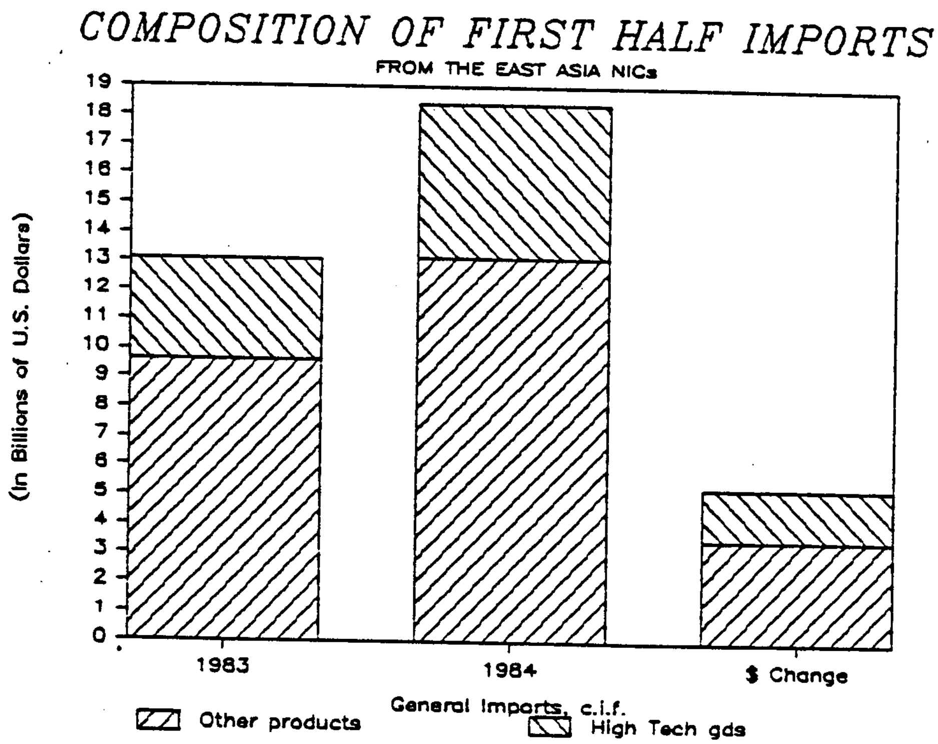


This sharp 1984 expansion in the U.S. deficit with these NICs was produced by a 41 percent jump in U.S. imports, constrasted with a very small U.S. export growth of 4.5 percent. The growth in first half imports from the East Asian NICs was an acceleration of an import growth trend that has persisted, even through the recession.

Our deficit with Taiwan exceeds the combined deficit with the other three countries, but developments with all four were significantly negative. Our balance with Singapore slid from a surplus into deficit, reflecting both a rise in U.S. imports and a decrease in exports.

Virtually all of the U.S. imports from the East Asian NICs are manufactures, while only two-thirds of the U.S. exports to them are manufactures. As with Japan, the high tech share of U.S. imports from these nations has been rising, reaching 29 percent in first half 1984, compared with 26 percent in first half 1983. U.S. high tech imports from these NICs rose by 52 percent, causing our deficit with them in high tech goods to triple, reaching $2.3 billion. (See Figure III.8.)

Figure III.8.



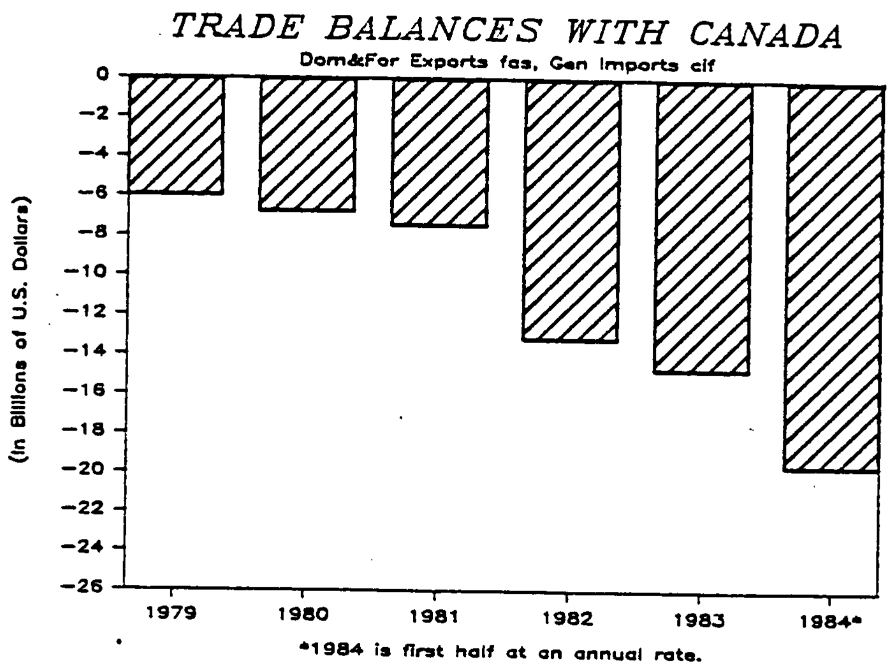
Key high-tech product import increases included: ADP machines, up four times from the first half 1983 to $365 million; ADP machine parts, up 56 percent to $856 million; telecommunications equipment and consumer electronics, up 44 percent to $1.9 billion; and electronic components, up 50 percent to $938 million.

Among non-high tech products, apparel imports were a major factor, increasing by $870 million (33 percent).

CANADA

Canada remains our most important trading partner, taking 22 percent of U.S. exports and supplying 20 percent of our imports. But, our deficit has been steadily growing. (Figure III.9.)

Figure III.9.



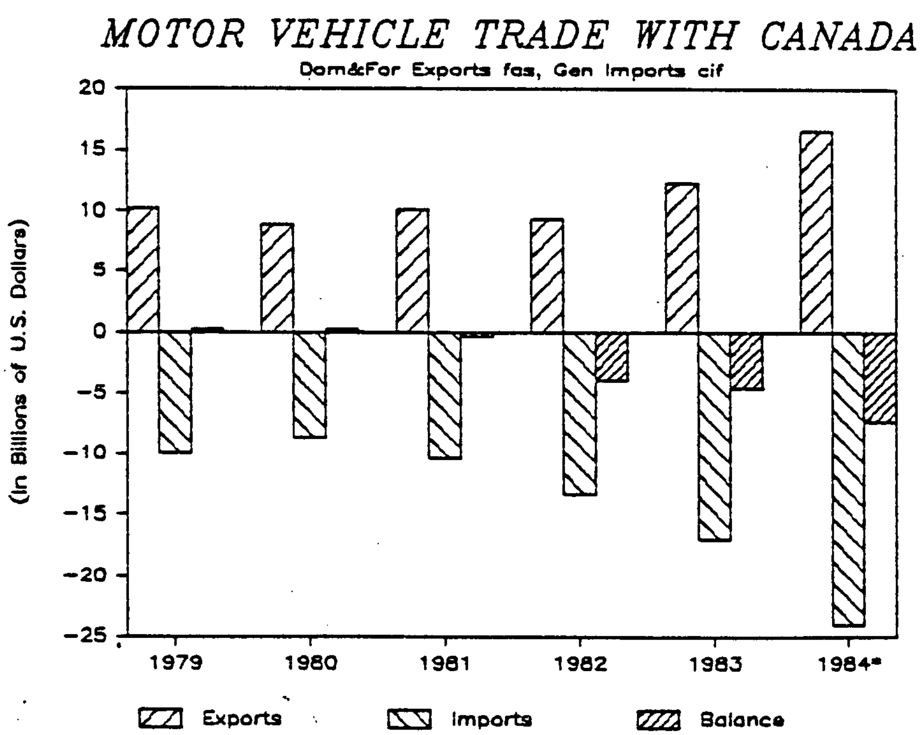
Our bilateral trade deficit with Canada is our third largest, exceeded only by Japan and by the East Asian NICs. Our first half 1984 trade deficit with Canada grew by 40 percent over first half 1983 to $9.8 billion.

U.S. exports to Canada increased by $5.1 billion, 28 percent, in 1984. A far greater dollar increase than to any other market and a larger percentage growth for U.S. exports than to any other key market, except Mexico.

U.S. imports from Canada increased $7.8 billion, a 30.5 percent rise, in the first half of 1984, a dollar increase exceeded only by that in U.S. imports from Japan.

The worsening in the overall U.S.-Canadian trade balance was virtually identical to the increase in the deficit in manufactures, from $780 million to $2.7 billion in 1984. More than half of the increase in the U.S. manufactures deficit was due to growth in the automotive products trade deficit. Imports of these products rose by 43 percent while exports increased by 32 percent. (Figure III.10.)

Figure III.10.



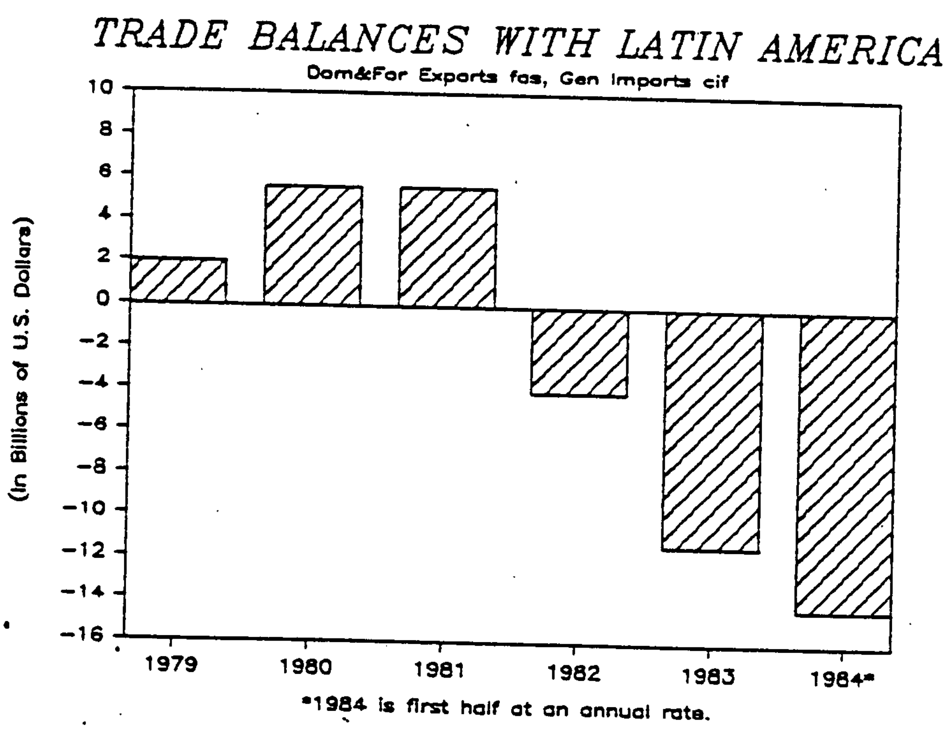
The U.S. high tech trade surplus with Canada has been a key bright spot in an otherwise worsening U.S. high tech position. In the first half of 1984, high tech exports to Canada exceeded imports by over 50 percent.

Even this surplus, however, lost some ground compared to 1983, as high tech exports increased by 25 percent but imports increased at a far higher rate of 54 percent. Most of the import increase was in aircraft and parts, and communications equipment, consumer electronics and electronic components.

TRADE WITH MAJOR LATIN AMERICA COUNTRIES*

The U.S. trade deficit with the major Latin American countries (excluding OPEC members Ecuador and Venezuela) continues to expand. (Figure III.11.)

Figure III.11.



The first half 1984 deficit rose by 29 percent over first half 1983, to $7.2 billion. Unlike previous years, however, the cause of the deficit

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*/ Formerly Latin American Free Trade Association (LAFTA)

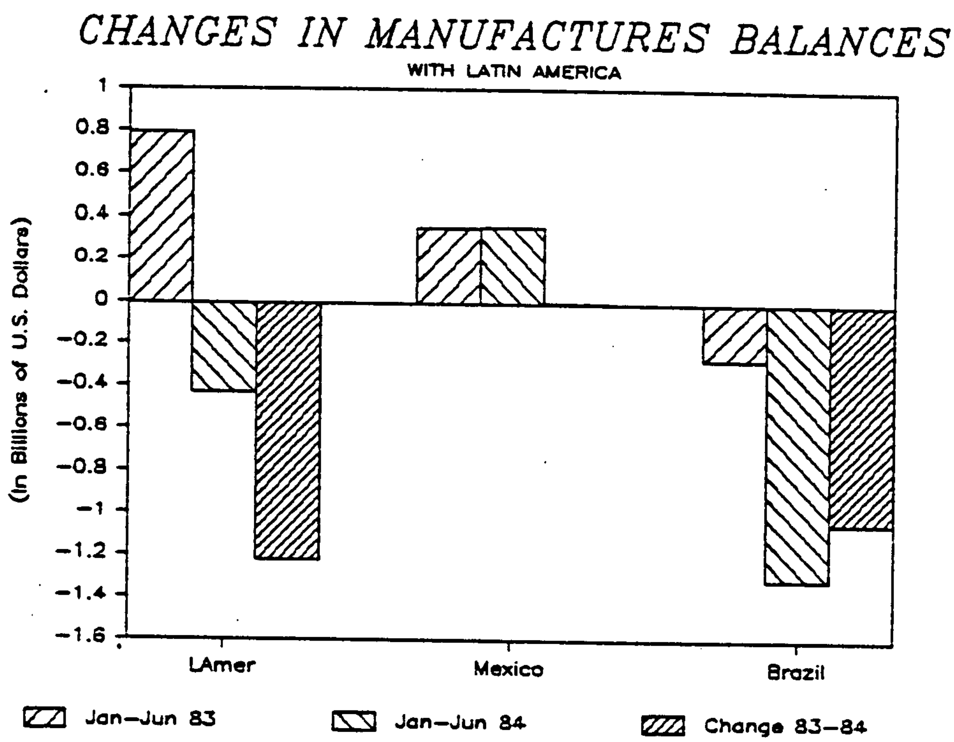
was not declining exports--exports actually increased by 13 percent--but imports which grew at a faster 19 percent rate. It should be noted, however, that the 19 percent increase in U.S. imports from LAFTA is well below the 31.6 percent overall U.S. rate of increase and significantly below the rates of increase from Japan, the East Asian NICs, and several other trading partners.

Since 1981, the U.S. has gone from a surplus of $5.6 billion on LAFTA trade, to a deficit now running at an annual rate of $14.2 billion.

On a bilateral basis almost all the first half 1984 deficit increase is accounted for by Brazil. With U.S. imports rising by 52 percent and our exports dropping 8.8 percent, our deficit with Brazil grew by $1.4 billion. With Mexico, our bilateral deficit actually declined by $393 million, based on an export growth of more than 29 percent that was larger than the import increase of $891 million (10.7 percent).

The growth in the deficit with LAFTA is due almost wholly to the shift in manufactures trade from a U.S. export surplus in the first half of 1983 to a deficit, a negative swing of $1.2 billion. Manufactures imports increased by 44 percent in first half 1984, while exports increased only 15 percent. (Figure III.12.)

Figure III.12.



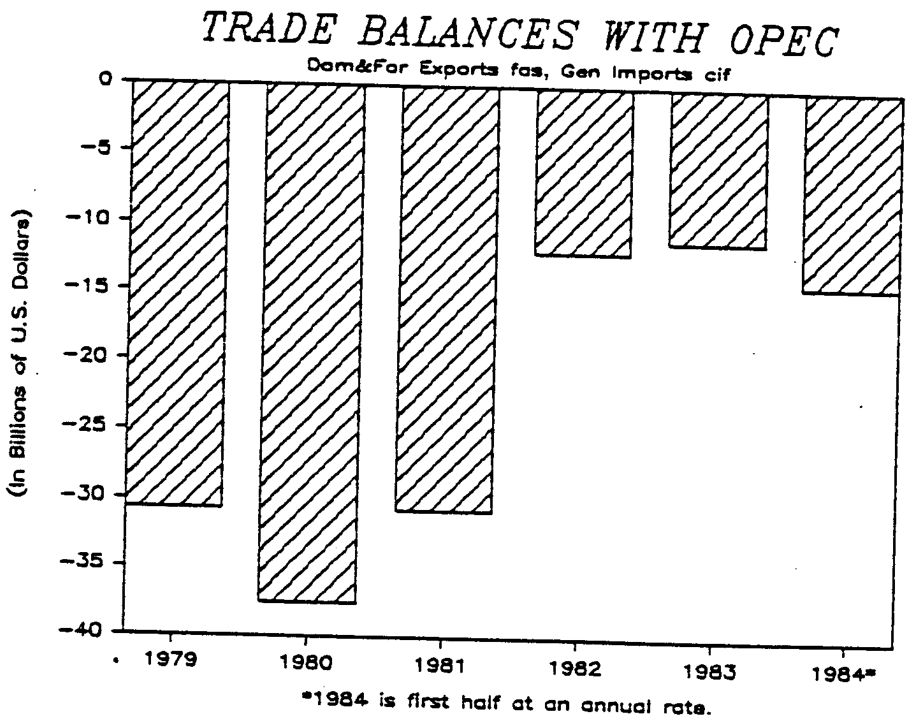
About three-quarters of this deterioration was in non-high tech manufactures; the rest was accounted for by a decline in the U.S. surplus in high tech products. Our high tech balance suffered because of a large (49 percent) rise in imports of high tech goods, almost half of which was communication equipment and electronic components from Mexico.

Import increases of non-high tech products from Latin America were spread across a number of products. Most significant were: iron and steel, up $234 million (81 percent); footwear, up $151 million (59 percent); and motor vehicles and parts up $466 million (54 percent).

TRADE WITH OPEC

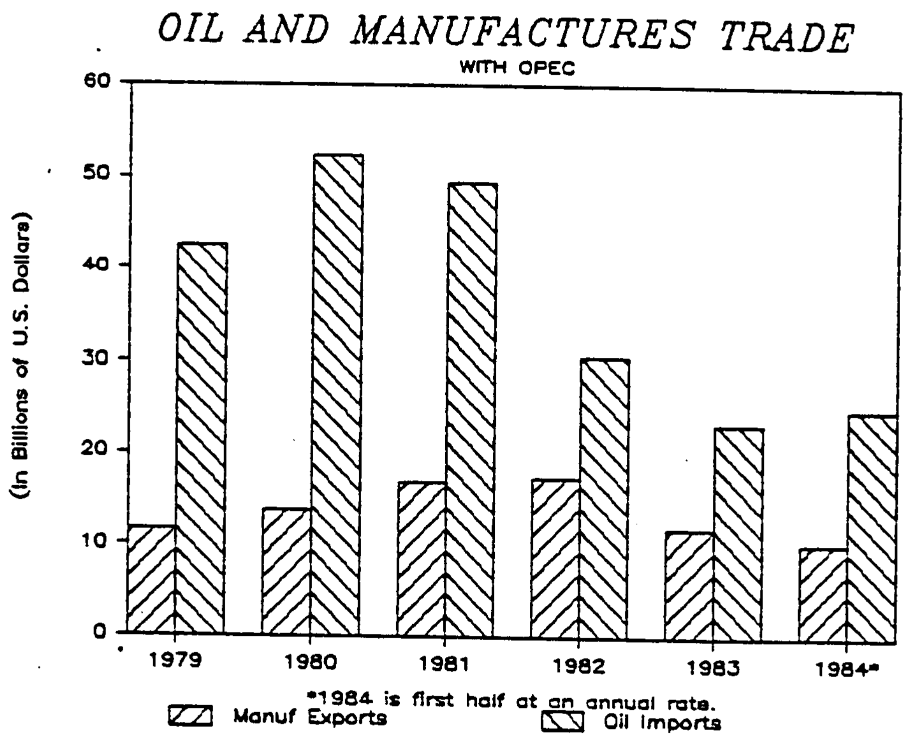
After declining since 1980, the U.S. trade deficit with OPEC has again increased. (Figure III.13.)

Figure III.13.



The first half 1984 deficit more than doubled over 1983, from $3.1 to $7.1 billion. This reversal results from the combined effects of a 28 percent rise in imports of OPEC petroleum and petroleum products and a 17.6 percent drop in OPEC purchases of U.S. manufactures, both high tech and non-high tech. (Figure III.14.)

Figure III.14.



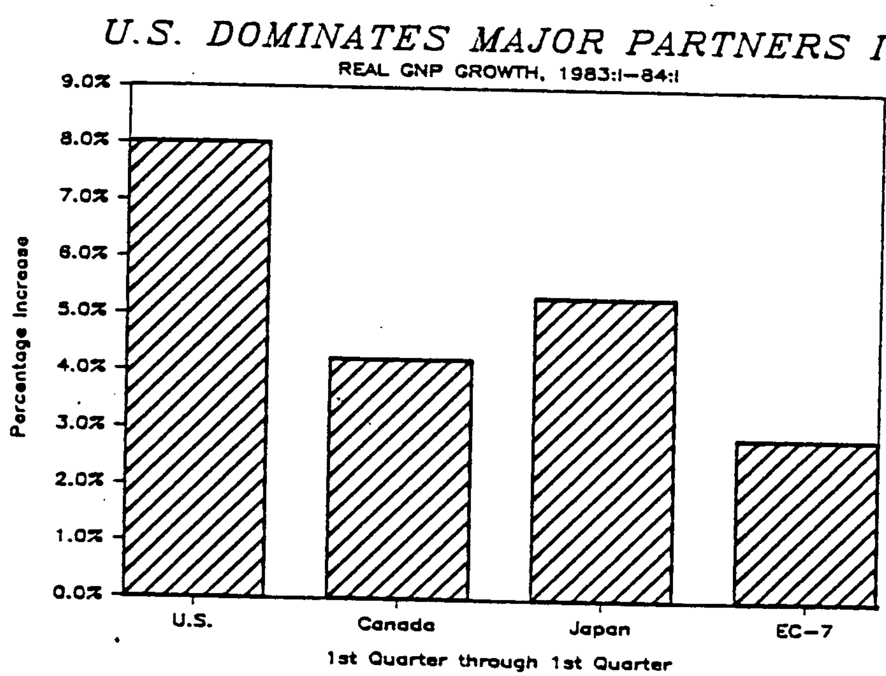
The decrease in exports of manufactures occurred in a number of products. Among the largest were aircraft and parts, $150 million (33 percent): motor vehicles and parts, $98 million (14 percent); and construction equipment, $70 million (16 percent).

IV. DEFICIT CAUSES

Excepting the LDC debt problem, the basic causes for the continued growth of the U.S. trade deficit have not changed from 1983. A high valued dollar and strong domestic economic growth relative to slow growth abroad continue to generate further deficit growth. The LDC debt problem had a major impact on the decline of U.S. exports in 1982 and 1983. Now, however, our trade balance with these countries, while not improving much, has at least stabilized.

U.S. economic growth has been faster than most forecasters anticipated, with strong effects on U.S. imports as both investment and consumer spending grow. Foreign economic growth, however, continues to lag, slowing U.S. export growth. (Figure IV.1.)

Figure IV.1.

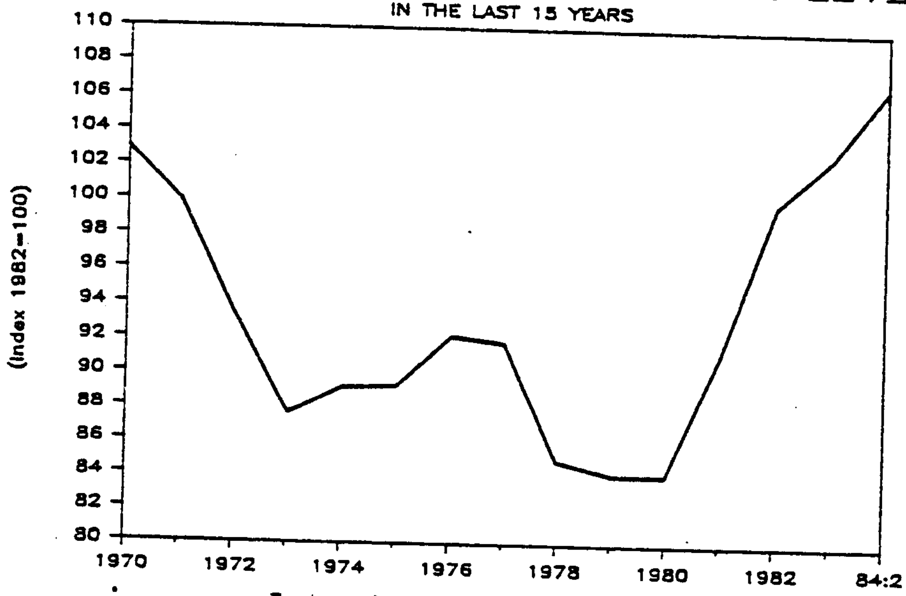


Because of the long lags between exchange rate changes and the effects on trade, the 1982 and 1983 increases in the value of the dollar are still being felt and will continue to be felt for some time to come. Moreover, as Figure IV.2 shows, the dollar has continued to appreciate in 1984. The effects of this most recent appreciation have not yet been felt in our trade.

Figure IV.2.

THE DOLLAR IS AT ITS HIGHEST LEVEL

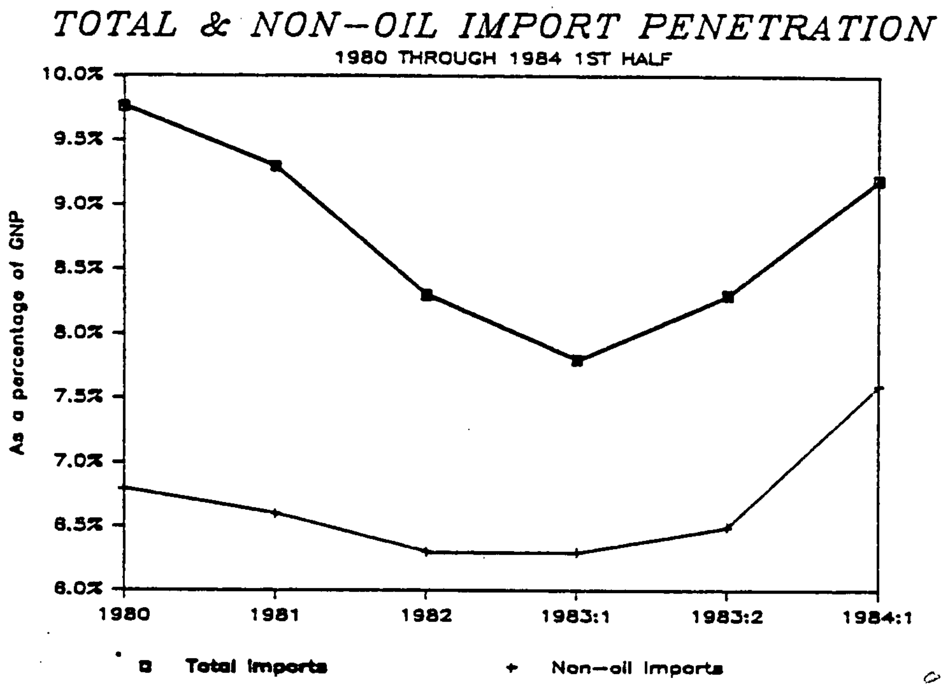
IN THE LAST 15 YEARS



Trade-weighted 14 country exchange rate

The effects of a strong dollar on our competitiveness can be seen in the increasing penetration of U.S. markets by imports. In 1984 penetration of the domestic market jumped. (Figure IV.3.)

Figure IV.3.



What is also dramatic is that the import penetration of U.S. markets (excluding oil imports) barely declined during the recession. Normally, imports fall faster than GNP. The increased penetration is even more pronouced in manufactures imports. In first half 1984, manufactures imports jumped to 9.9 percent of total U.S. manufactures shipments compared to 8.2 percent in 1983.

As Figures IV.4a and IV.b shows import penetration is accelerating in both capital and consumer goods. For capital goods the penetration ratio doubled between 1978 and 1984.

Figure IV.4A.

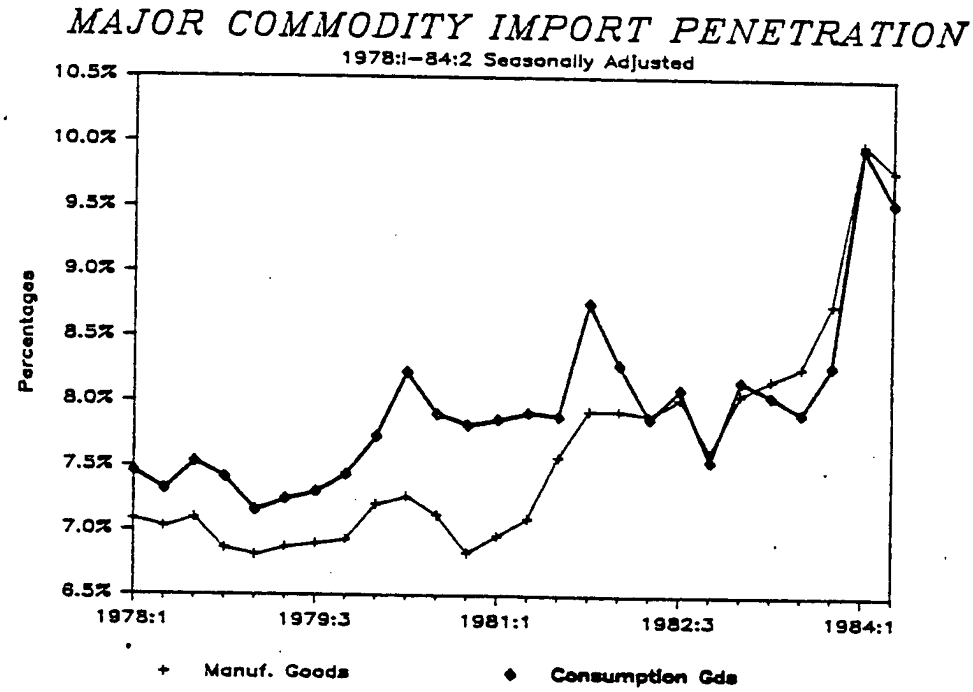
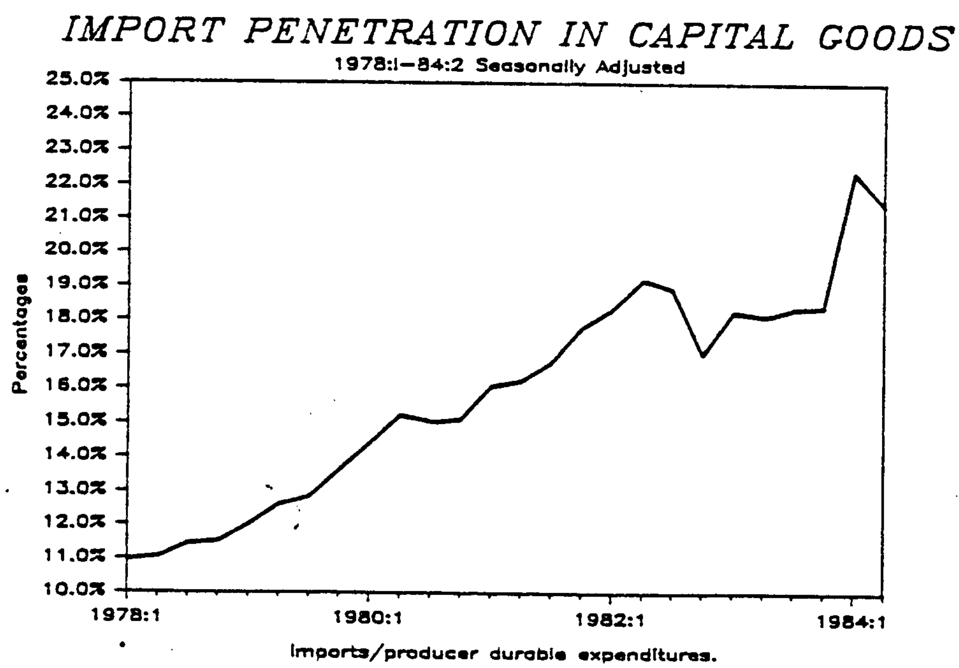


Figure IV.4B.



QUANTIFYING THE EFFECTS OF EXCHANGE RATES AND INCOME

In order to get some idea of the magnitudes of the effects of a stronger dollar and relatively faster U.S. economic growth, several simulations were performed using the OTIA trade model. These simulations indicate that exchange rates have probably had greater effects on our trade deficit than the growth rate differences.

OTIA investigated what the deficit would be in 1984 and 1985 under two different sets of assumptions. First, if U.S. economic growth had been half as fast, beginning in 1983, as actual rates. Second, if the dollar had appreciated only half as fast as actually experienced since 1980.

Table IV.1. on the following page shows that the lower exchange rate has much more dramatic effect. A weaker dollar would reduce the deficit by more than $100 billion in 1985 even though continued strong economic growth is assumed. Slower GNP growth on the other hand would would reduce the deficit by about $50 billion. These results are broadly consistent with other analyses. If, for example, import penentration had held constant from 1983 to 1984 the deficit in first half 1984 would have been 40 percent lower. Thus, it is increased penetration which is primarily the result of increased foreign competitiveness, and not domestic economic growth which is the main force propelling our trade deficit upward.

TABLE IV.1
EFFECTS OF GNP AND EXCHANGE RATE CHANGES
ON THE TRADE DEFICIT

SIMULATION	1984	1985
Base		
Exports	213	277
Imports	346	400
Balance	-133	-173
Lower GNP		
Exports	213	227
Imports	318	351
Balance	-105	-124
Lower ER		
Exports	260	283
Imports	308	348
Balance	-48	-65

Note: These simulation results must be interpreted cautiously. The OTIA trade model is relatively unsophisticated and subject to large forcasting errors.

Source: DOC/ITA/OTIA

It is important to bear in mind these simulations and other "what if scenarios" take no account of the feedback effects of the changed exchange rates, GNP growth, or trade on either the U.S. economy or on other economies; e.g., slower U.S. growth and lower imports would slow growth abroad and affect our exports; a lower dollar would probably increase inflation which would, in turn, affect our competitiveness.

Finally, assuming a reduced growth rate in the dollar exchange rate, as is done in the second simulation begs some explanation as to its cause. Any policy change that might bring a lower valued dollar (e.g.- a reduced fiscal deficit, a different monetary policy) would also have effects on

U.S. trade trends both directly, and indirectly through possible monetary and fiscal policy changes of our trading partners as they react to a lower valued dollar.

Nevertheless, the results can establish rough orders of relative magnitude and do clearly indicate how significant the high value of the dollar is to U.S. trade, and also the effects of strong economic growth.

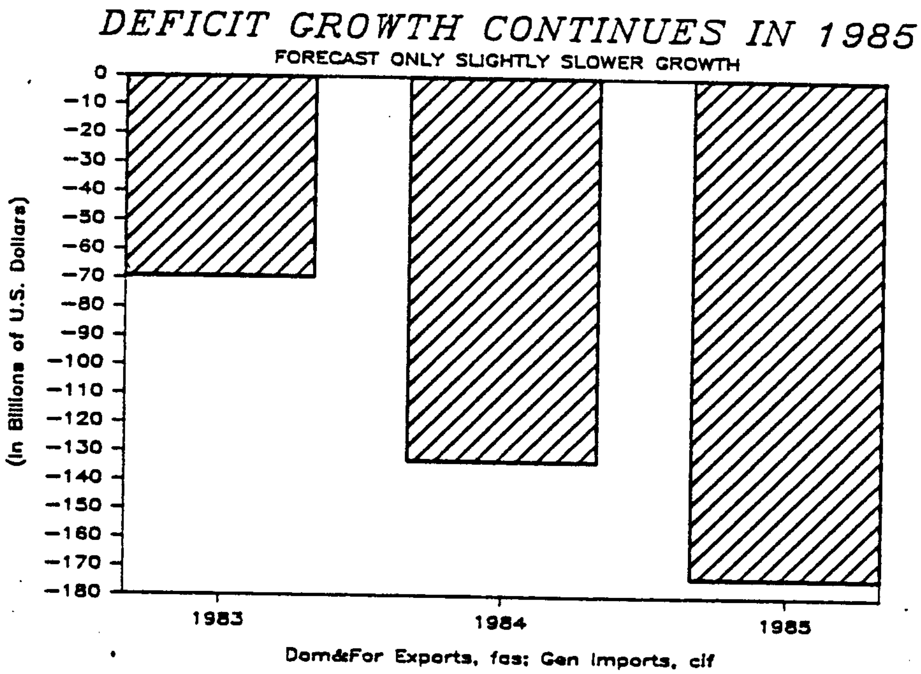
V. TRADE OUTLOOK

The U.S. trade deficit will continue to grow in 1984 and will total around $133 billion for the year as a whole. Exports are unlikely to grow more rapidly than in the first half of 1984. Economic growth in Western Europe is likely to continue, but not at a greater pace than the current slow mid-year rate. The worst appears over for the debt ridden LDCs, but their effective import demand is likely to remain constrained by a need to maintain large surpluses to support debt servicing requirements.

To the extent that the U.S. economy continues on its current growth path, rising domestic demand will increasingly be supplied by imports. However, the growth in demand in the last half of 1984 is unlikely to match that in the first half. Furthermore, the effects of the increase in price advantage to foreign competition produced by the 1980-83 dollar appreciation, while not yet spent, should moderate somewhat. Petroleum imports, however, are likely to continue rising to satisfy the energy demands of the growing U.S. economy.

The outlook for 1985 suggests there will be no relief. The OTIA trade model forecasts a deficit in the range of $170 to $175 billion. (Figure V.1.)

Figure V.1.



Exports will grow at about the same rate as in 1984; imports will grow at a somewhat slower rate than in 1984, but the import growth rate will continue to exceed that of exports; hence the continued deficit expansion.

This $170 billion deficit forecast assumes only about a 5 percent decline in the dollar over the remainder of 1984 and no further drop in 1985. Even if the dollar dropped more, the effects would not be large in 1985.

The size of the 1985 trade deficit has been largely determined in advanced by events and conditions which have already occurred or are likely to change only slowly. For example, suppose the dollar dropped precipitously by 15 percent, as of 1 October, and remained at that lower level throughout 1985. The deficit in 1984 would, according to the OTIA trade model, actually show a small increase, and in 1985 the deficit would be only $28 billion lower than the $170 billion deficit baseline forecast.

Oil price changes are, of course, one important exception. A precipitous decline in oil prices would have immediate effects in reducing our trade deficit. However, barring sharp oil price declines we can look for no early relief from these large deficits.

VI. IMPACT OF TRADE DEFICITS ON THE U.S. INTERNATIONAL INVESTMENT POSITION

Over the decade prior to 1982, the United States was able to offset its frequent merchandise trade deficits with surpluses in trade of services. (For BOP purposes services include the trade of service industries, receipts and payments of income on direct investments and other assets abroad and in the U.S., and fees and royalties transfers.) During the period 1975-80 these services surpluses averaged over $20 billion annually. As a result, the U.S. current account was essentially neutral over the entire 1970-82 period, despite often large merchandise trade deficits.

Dramatic increases in the merchandise trade deficit beginning in the second half of 1982, however, overwhelmed the ability of the service account surpluses ($35 billion in 1982 and $28 billion last year) to offset our trade deficits. As a consequence, the current account deficit was over $9 billion in 1982 and almost $42 billion last year. Based on our merchandise trade projections, we expect the current account deficit will reach $80-85 billion this year and will most likely exceed $100 billion in 1985!

These unprecedented deficits have important--primarily negative--implications for the U.S. international economic position. It is important to recognize that our current account deficits, by definition, must be financed by foreign capital. This phenomenon is reflected in the rapid decline of the positive net U.S. international investment position. (The net international investment position is defined as the difference between the value of U.S. assets abroad and the value of foreign assets in the U.S.).

The U.S. balance on international investment has long been positive; i.e., on balance the U.S. has been a "creditor" rather than a "debtor" nation. (It appears that the last time the United States was a debtor nation was prior to World War I.) The positive international creditor position accrued gradually over recent years, increasing from $58 billion in 1970 to a 1982 peak of $149.5 billion. Since then, however, the balance has declined rapidly and the decline is accelerating as a consequence of enlarging trade deficits. Table VI.1 shows the decline in the U.S. net international investment during 1983 and its correlation to the increase in the U.S. current account deficit.

Table VI.1.
U.S. International Investment Position & Current Account Balance
(In Billions of Dollars)

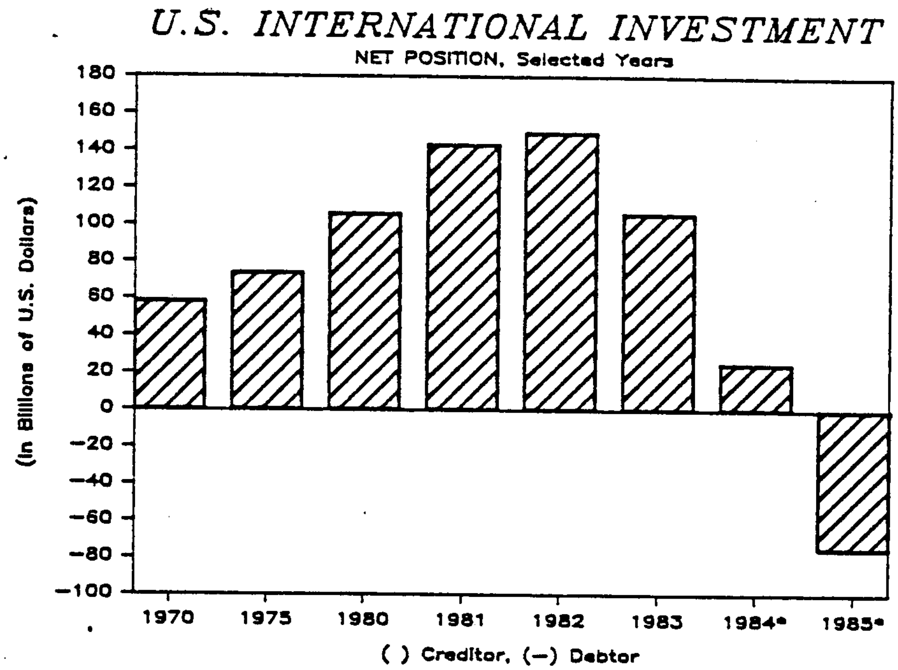
	1982	1983
U.S. Assets Abroad		
USG Official Reserves	$108.3	$113.1
Direct Investment Abroad	221.5	226.1
Portfolio Investment	75.6	84.8
U.S. Claims Reported by U.S. Banks	404.6	430.0
Other Private Investment	28.2	33.5
Total Assets	$838.1	$887.5
Foreign Assets in the U.S.		
Foreign Official Assets	$189.0	$193.9
Foreign Direct Investment in U.S.	121.9	133.5
Portfolio Investment in U.S.	93.6	114.6
Liabilities Reported by U.S. Banks	257.1	314.3
Other Private Liabilities	27.0	25.2
Total Foreign Assets	$688.6	$781.5
NET INVESTMENT POSITION	$+149.5	$+106.0
U.S. Current Account Balance	$ -9.2	$ -41.6

While there is not necessarily an exact one-for-one correspondence between trends in the U.S. current account and the U.S. international investment position, the fact remains that the burgeoning current account deficit must be financed by foreign capital.

We expect that foreign capital will continue to flow into the United States over the short term, continuing to maintain the strength of the dollar that is the major cause of U.S. current account trends. High U.S. interest rates and relative price stability are making the United States a very attractive investment opportunity relative to investment alternatives in other countries. In addition, the United States is seen as a "safe haven" by foreigners seeking to protect the value of their assets in a world characterized by areas of economic, political, and military instability.

Figure VI.1 illustrates the probable impact of the forecasted 1984 and 1985 current account deficits on the U.S. net international investment position. Data for 1983 and prior years are those published by the Bureau of Economic Analysis. The estimates for 1984 and 1985 assume that virtually all of the current account deficits will be reflected in the data published by BEA. Thus, the United States will become a "debtor nation"--as defined by a net <u>negative</u> international investment position--sometime in 1985. The implications of this development are addressed in the next section of this report.

Figure VI.1.



*1984-85 are DOC/ITA/OTIA estimates based on the assumption that current account deficits will be fully reflected in the appropriate investment accounts.

Note: The net international investment position of the United States is defined as the difference between the value of U.S. assests abroad and the value of foreign assets in the United States.

Source: DOC/ITA/OTIA using Bureau of Economic Analysis data.

It should be noted, moreover, that the BEA data may not fully reflect the declines in the current net international investment position. Large inflows of dollars from abroad over the period 1979-83--a cumulative total of $127 billion--appear in U.S. accounts as "statistical discrepancy", reflecting the fact that they could not be assigned to specific data elements. Since it is more likely that these inflows reflected capital inflows to the U.S. rather than unrecorded current account items, there is a strong probability that the positive U.S. net international investment position is overstated. It is even possible that the United States is, in fact, already a debtor nation.

The rise in the value of foreign assets in the United States relative to U.S. assets abroad will tend to reduce the current account surplus on services in future years, since income payments on these U.S. liabilities will increase relative to income receipts on U.S. assets. As recently as 1983 the United States recorded a surplus of almost $10 billion on these income transactions. In addition, the more rapid growth in recent years of foreign direct investment in the U.S. compared to U.S. direct investment abroad will tend to reduce the U.S. surplus on income from these investments in future years. The 1983 surplus on direct investment income was a healthy $14 billion, but was still dramatically below the 1979 record high of almost $33 billion.

VII. IMPLICATIONS FOR THE U.S. ECONOMY

The very large U.S. trade deficits and the resulting transition of the United States from a creditor to a debtor nation will have many important effects on the domestic economy and on our international economic position. Some of these effects can be foreseen, many cannot. This section identifies a few of the important effects which seem likely, but is not a thorough examination of the subject.

Oversimplifying in describing a complex situation, we expect the continuing huge trade deficits will soon change the United States from a creditor to a debtor nation. So long as foreigners are willing to continue to finance our trade deficit this can continue without significant depreciation of the dollar. At some point, however, willingness to continue to enlarge lending to the United States will wane and the dollar will decline.

In what follows, we briefly list some of the consequences of the trade deficit, our soon-to-be status as a debtor nation, and depreciation of the dollar.

EFFECTS OF THE U.S. TRADE DEFICIT

Likely effects of continuing huge trade deficits include the following:

- As deficits continue to grow and as import penetration accelerates in more and more industries, pressure for protectionist measures will likely increase, particularly if domestic economic growth slows markedly from its current rapid pace.

- Low priced imports will continue to help restrain inflation, both through the products provided and through competitive pressure on U.S. producers.

- The U.S. international investment position will deteriorate rapidly, with the U.S. becoming a larger debtor than either Brazil or Mexico sometime in 1985 or 1986.

- Sooner or later, the trade deficit will bring a depreciation of the dollar, beginning a process that will ultimately shrink the trade deficit, if not restore balance.

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SOME EFFECTS OF DEBTOR NATION STATUS

Creditor-debtor relationships among nations are essentially the same as among individuals. The consequences of U.S. entry into debtor nation status will include the following:

- In lieu of net positive interest receipts from abroad, the U.S. will be, on balance, paying out to foreigners. Thus, net interest, up to now an income item that was an important offset to trade deficits, will become a contributor to current account deficits.

- Increasingly, with regard to the national debt we will no longer be able to say "we owe it to ourselves".

- Borrowing abroad--the result of trade and current account deficits enables us as a society to consume more than we produce. Only so long as foreigners are willing to increase their lending to us, will we be able to continue to consume more than we produce.

- But the inflow of foreign money cannot go on forever. When foreigners are no longer willing to expand their lending each year we must begin to produce more than we consume.

- Without foreign lending, Federal borrowing would increasingly displace business borrowing in the capital markets -- if the Federal Reserve follows its current course.

DOLLAR DEPRECIATION

Depreciation of the dollar will be the ultimate product of huge trade deficits and an increasing external debt. Dealing daily with export oriented and import vulnerable industries that are having a difficult time competing in both U.S. and foreign markets, we in the Department of Commerce may tend to view a dollar depreciation as a desirable event. But the depreciation, whenever it comes, will have both positive and negative effects. For some individual industries the effects may be mostly beneficial, but for the economy as a whole, there are more negative effects.

Some potential effects of a dollar depreciation are:

- o Increased ability of U.S. industry to compete in U.S. and foreign markets, with positive employment effects.

- o In terms of real resources, we must export more to pay for a given amount of imports. Ultimately, this lowers real wages and the standard of living.

- o Since imports of both consumer goods and industrial raw materials will cost more, domestic inflation will be given a boost.

- o A very rapid decline of the dollar could disrupt trading and financial patterns.

- o A weakened dollar may limit fiscal and monetary policy flexibility.